THE NEW PLACE OF THE STOCKHOLDER

JOHN H. SEARS

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THE NEW PLACE
OF
THE STOCKHOLDER

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BY

JOHN H. SEARS

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THE NEW PLACE
OF THE STOCKHOLDER

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To My Mother

THIS BOOK IS AFFECTIONATELY

DEDICATED

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PREFACE

THE word "stockholders" usually brings to mind its legal associations. For that reason it might be thought that a book on this subject would be a legal treatise. But that is not my purpose. The legal phase is so important that frequent reference thereto cannot be avoided, but from the standpoint of a comprehensive view there are involved purely economic considerations, matters of convenience, something of practical philosophy and of business common sense.

To study and to make note and brief comment upon all of these for the general reader, the promoter, the banker, the broker, the legislator, the lawyer, the student, the stockholder himself—in fact for all who come into practical and theoretical contact with the corporation—is the aim of this book.

Whenever it is sought to emphasize the personal relation of a stockholder to an enterprise he is referred to as a "partner." The purely individual relation of a partner to a partnership has never been lost. Hence the strong implication of the personal and individual by use of this term. It is needless to state that such use of the word "partner" is inaccurate. It does, however, call attention to the actual shifting of the "stockholder" into a position of absenteeism and dissociation from his enterprise.

At the same time that this has been going on there has been a great increase in use of the corporate form, wider distribution of stock, and an obscurely defined effort to protect, to help, and to use the stockholder to a greatly increased extent.

The subject of stockholders thus takes on an increased importance, involving new angles of investigation and new methods of treatment. If I have succeeded in stimulating thought along these lines and have made suggestions which will be adopted, in whole or in part, my efforts will have been amply rewarded.

My employment for many years, usually in association with other counsel, in the organization and maintenance of corporations has been the principal source of material and the basis on which I confidently place the greater part of the constructive conclusions stated in this book.

JOHN H. SEARS.

120 Broadway, New York City.

PROLOGUE

[*Irish wit applied to current topics brings to mind Mr. Dooley (Peter Finley Dunne). We regret, with many others, no doubt, that he is now so seldom heard from. We wish we could quote him in the present instance, but we are forced to have recourse to our own Michael Malone, a loafer philosopher from the Emerald Isle.*]

"I see be the papers, Finnegan," says Mr. Malone, taking the old blackened pipe from his mouth, "that Clarence Dillon didn't do so well with that non-votin' stock in Dodge Brithers that the Harvard profissor put up such a holler about."

"Phwat's the story?" asks Finnegan.

"The way I heard it," replied Malone, "is that Dillon Rade bought up the Dodge Brithers business for some troifle loike one hundred an' forty-six million dollars, an' gits one hundred and sixty million dollars from the public be sellin' thim bonds, preferred stock, and non-votin' common stock, kapin' the intoire issue of votin' common stock fer thimsilves. A mere fourteen millions besoides conthrol o' the company to kiver expenses and go into the profits of Dillon Rade. That wasn't so bad, eh?"

"Sure," says Mr. Finnegan, "it ain't bad fer the bankers, but it ain't so good fer the public. It sounds loike Wall Strate, all right."

"There yez go," says Malone, "talkin' loike the rist of the gineral crowd, blackguardin' Wall Strate; wait 'til yez hear the rist av it. Along comes Profissor Ripley of Harvard, representin' Main Strate, and lambastes the corporations fer cuttin' down stockholders' rights, be non-votin' stock, be

feriver waivin' their right to buy new stock before outsiders git the chanst, be givin' the directors an' officers free discharge in advance for chatin' their own company, and so on. In short he gives Wall Strate the divil fer cuttin' down the stockholders' rights."

"Stockholders' rights?" says Finnegan. "I didn't know they hed any rights."

"Shure they have rights," says Malone. "Don't they own the business?"

"Go on wid ye," says Finnegan. "Somebody's been kiddin' ye. I niver thought ye was so gullible, Mike. Ain't I mesilf a stockholder in that mine out West promoted be that cousin of Clancy that bate it last spring? Bad luck to him! Do I own anything? Not so far as I know. The corporation owns whativer there is, if there is anything. I looked fer that corporation, but I niver could foind it. I'm holdin' the bag, so far as I can see. Stockholder! Sackholder is more loike it, Mike. Wheriver did ye get the idea that the stockholders own the business?"

"Well," says Malone, "I am digressin' from me story, but I see ye need a little educatin' before I go any further. You know Mike Casey what used to own the saloon on the corner until prohibition increased the liquor traffic?"

"Shure I remimber him," says Finnegan. "But phwat has that got to do with it?"

"Well," says Malone, "Casey is a capitalist now, livin' in Azey Strate. He is a stockholder—a owner in Gineral Motors."

"Is thet so? I thought it was Spakeazy Strate, and bootleggin' that done it," interposed Mr. Finnegan.

"I called on Casey the ither day," continued Mr. Malone, ignoring the interruption. "Casey was in the front parlor, smokin' a big 'Carona,' with a pile of poipers around him. 'Casey,' says I, 'I am glad to see ye enjoyin' the fruits of

prosperity. How did ye do it?' says I. 'Here, help yersilf,' says Casey, passin' a box of the foine cigars. 'Whin I sold the buildin' an' corner lot containin' the old saloon of blissed mimory, me oldest son, Patrick, the wan that works on Wall Strate, persuaded me to invist most of the proceeds in Gineral Motors—an' now I'm gittin' profits—dividends they call thim—hand over fist from me business.'

"'Yer business?' says I. 'I thought ye wuz only a stockholder.'

"'So I am,' says he, 'but that makes me a part owner,' says he.

"'I thought the corporation owned the business,' says I.

"'You're right,' says Casey, 'the corporation owns the business, but the stockholders are the corporation, me prisident, Mr. Sloan, makes it very plain. Look at this,' says he, passin' me over a lot of documents an' papers. An' sure enough there was a long report be Prisident Sloan tellin' Mr. Casey that the stockholders were the owners and tellin' thim all about the business and the future plans. 'I have jist been radin' about our business in Canada,' says Casey, 'an' about how the sales overseas are growin'. I bought a Buick for mesilf from mesilf last year, and I think it will be a Cadillac next year,' says he.

"'You greatly surprise me,' says I. 'I thought the best any stockholder could git was a ride in the rumble sate.'

"'Not any more,' says Casey. 'Me son tells me that invistors is gettin' informed of their rights an' they won't be buyin' stock pretty soon except in companies where the driver realizes he is the chauffer.'

"'Ye don't think the stockholders will start any back-seat drivin', do ye?' says I.

"'Not fer long,' says Casey. 'No dacent chauffer will stand fer it. But he will recognize the master's voice in givin'

directions as to where to drive, an' he will account to the owner fer any private usin' of the car.' "

"That's all surprisin' to me," says Finnegan. "I thought the bist a stockholder had wuz a ticket in a lottery, and ginerally a crooked lottery at that."

"Ye're wrong," says Mr. Malone; "an' that brings me back to the story I started with. Wall Strate runs as straight a game as they can—that is, the good bankin' houses an' corporations do. Of course, there is always a bunch of crooks hangin' around the edge, runnin' shell games. But the good houses do the right thing in the long run; at laste they try to. As I wuz sayin' at the start, that non-votin' stock in Dodge Brithers didn't work out so good. When the proposition to sell out to Chrysler came along, Dillon decided that, even though the law gave thim the entoire right to make the deal through their ownin' all the votin' stock, they would rather have consent from the holders of the preferred and the other common stock. So they amended the charter, givin' all stockholders the right to vote. To climax the matter Dillon had to go out in the market and buy a lot of preferred stock so as to secure enough votes to close the Chrysler deal. Ye see, Finnegan, they stood by their proposition to the end an' didn't rely on this new-fangled non-votin'-stock idea, after all."

"I see," says Finnegan. "Consent is consent an' it is better to have everybody willin' in a proposition where ye want all parties to pull together, than to have thim unwillin'. To know they are willin' there is no better way than to git their vote. Who started this idea of pullin' together without consent, or consentin' without bein' willin'? Do you know?"

"Some of these so-called opportunists, Finnegan," remarks Mr. Malone in a philosophical tone and with a far-away look in his eyes. "There is always somebody bobbin' up who thinks he has a new idea, which is ginerally somethin' long

ago thought of and abandoned be our forefathers. People of rale wisdom will soon be lookin' fer new and more ways to safeguard raythe than to further belittle the stockholder. I'm thinkin' of the time to come whin the public will laugh at the stockholder ridin' in the rumble sate of his own car, an' the expression on that stockholder's face whin he begins to realize how ridiculous he looks."

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The New Place of the Stockholder

Chapter I

INTRODUCTION

THOSE who place a halo over the head of business no doubt exaggerate. Progress only appears when the subject is viewed in retrospect. That there is still plenty of room for improvement is clear when vision looks squarely at things as they are today and also peers into the future.

John T. Flynn in the *Forum* for October, 1928, puts it thus:

> If I have any criticism to make of today's business morals, I have no tears to shed over the old-fashioned business man. His rules of conduct were few, simple, and crude. "Business is business"—that was his slogan. And he had fairly exhausted the resources of apologetics when he explained that he was not in business for his health. . . . For one reason or another the old order is passing in which the merchant bargained with his customer and lied ignobly in the process. He asked a big price and came down if he had to. That is now unethical. Now he asks a big price and sticks to it. Instead of charging one man a dollar and another man two dollars for a fifty-cent razor, he charges everybody five dollars and the light of heaven shines upon the transaction. The old merchant cared little about what was in the packages on his shelves or what was on the labels of the packages, and the manufacturer was equally indifferent to what he put into them. . . . There is a vast distance to be traveled. There still lingers a fear in the popular mind about corporations. The fear is misdirected. I do not fear great rich corporations, but rather the rich men who control them and employ the opportunities for vast gain which that control gives. . . . When the great corporation official who exploits his corporation is written down by business men as a grafter like the public

official who exploits his city and country, then there will be some excuse for boasting of the "morals of modern business."

"Our whole business system would break down in a day if there was not a high sense of moral responsibility in our business world," says Herbert Hoover.

"Every institution," writes W. Randolph Burgess in *Reserve Banks and the Money Market,* "gradually gathers around itself a group of facts about its operations and an interpretation of these facts which becomes its operating philosophy." And from the man in the street, too busy to examine into the whys and wherefores of these matters, how often do we hear expressions such as, "It is not right, I don't care what the law says"; "It's not square"; "It is (or it is not) the right thing to do." In discussing corporate legal problems with officials and associate counsel I find that conversations somewhat like the following frequently occur: "The statute says so and so and the by-laws provide thus and so, and we have a court decision that sustains this view." "Yes, but is it right?"

To give a concrete example: Directors of an Ohio corporation prominently engaged in the manufacture of motor trucks desired additional working capital; an increase of capital stock in sufficient amount had been authorized by the stockholders at a meeting held five or six years ago, but the necessary statutory steps had never been taken to complete this issue. Could these steps be taken now, and the holding of another stockholders' meeting for this purpose be avoided? Such a meeting would cause delay and the necessary vote would be difficult to secure because the stock was actively traded in on the New York Stock Exchange and most of the stock stood in "street names" (in other than in the names of the present true holders), addresses would be hard to secure, in addition to the fact that many of these holdings were

changing every day. There was nothing in the statutes of Ohio and no published court decision to indicate that the procedure to complete the previous additional stock issue should be completed within any certain length of time. On this point the law was silent. Of course, it could be argued that no length of time being stated, a "reasonable" length of time is implied. But what is a "reasonable" length of time? Moreover, who *legally* could or would complain of such procedure? Certainly here was an opportunity to take the "easiest way" and still be "within the law." Nevertheless, all the troublesome work was done, a new special meeting of stockholders was held, the necessary proxies were obtained, and all because this evidently was the fair and right thing to do, since the old authorization was not generally known nor could it be known by reference to ordinary sources of information, such as current financial rating books, brokers' statements, etc.

Such procedure of fair dealing is the result of appeal to the fundamentals, to the thoroughly-thought-out thoughts upon which corporations are founded, to the philosophy of corporation law. The conception of a corporation as "invisible, intangible and existing only in contemplation of law" (Chief Justice Marshall's classic definition), was the corporate conception, which our Lord Coke said has "no body to be kicked and no soul to be damned." The more recent definitions refer to groups of individuals merely endowed by law with certain methods of holding title and of doing business.[1]

[1] "A corporation is more nearly a method than a thing, and the law may treat it as a name for a useful and usual collection of jural relations, each one of which must be ascertained, analyzed and assigned to its appropriate place according to the circumstances of the particular case, having due regard to the purposes to be achieved. A confirmation of this analysis of the corporate form is found in the fact that the word 'corporation' has a variable, not a constant meaning. The rights and

The point of view that a corporation is an intangible being "existing only in contemplation of law"—the so-called "mystic entity theory"—has a political angle to it—a portioning out of a part of the state's sovereignty to a favored group who have secured a "franchise." This in no way conforms to the facts today, when certificates of incorporation may be filed by practically anyone, and provide for what the parties—"joint adventurers"—contract for. This is the "contract" or "continental" theory of corporate organization.

Mr. A. A. Berle points out some of the advantages of discarding the corporate entity theory and adhering to the "contract" theory:

> If the essence of corporation lies in contract and not in governmental decree; and if the function of the state is limited to regulation with a view to protect itself or of controlling quasi-governmental rights granted by it, our theory of stockholders' rights and the possibility of changing them by charter amendments or statutory authority is wholly changed. The state may alter, amend and repeal charters no doubt, but this alteration, amendment and repeal must be limited to dealings with the rights of government monopoly, or peculiar privilege which the state has granted to the corporation. . . .
>
> Again at present a corporate stockholder has no recognized duties to other corporate stockholders. He may hold a large block of stock of the X corporation, and may nevertheless work towards the wreck of the X corporation for some reason of his own. If, however, he is virtually

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obligations comprised within the compass of the word change not only with time, but with locality. Limited liability of the shareholders is a comparatively recent invention. Limited and unlimited liability existed side by side, even within this state, under the Laws of 1875. The extent of limited liability varies under different statutes. Corporations with no par stock are now quite common. Methods of transacting business, conditions under which dividends may be declared, and all the details of what are commonly known as corporate activity are actually different in different jurisdictions. Moreover, endless variants of these features may be conceived of without doing violence to the general designation 'corporation.'" Farmers' Loan & Trust Co. v. Piersen et al (1927), 130 N. Y. Misc. 110, 222 N. Y. Supp. 532.

a joint adventurer, he has certain obligations not to damage his associates. It is a fair question whether bear raids on the stock exchange by certain stockholders to the detriment of others will be considered legal two decades hence.

Still more important is the result that the common law will have regained its position in dealing with corporations unhampered by much limitation of statutes. It has, of course, done this to some extent in times past. Since the day when the Massachusetts Supreme Judicial Court in Gray *v.* Portland Bank[2] insisted that a new issue must be offered ratably to all shareholders, it has been obvious that every once in so often the common law would occasionally enter the field. Invariably resistance was offered, however, on the ground that the legislature created the entity and held it in the palm of its hand. Reference was had to the statute and charters; within the four corners of these documents the rights had to be worked out. But if the undue position of the government is once disposed of we shall have the familiar situation of relationship entered into by contract, the contract being subject to legal rules and police regulation; and we have added duties and liabilities imposed by the common law arising from the status or relation which thereby has resulted.

In a recent charter it was written that directors might trade with their own corporation to the disadvantage of the latter, even though they concealed their interest in the transaction. From the point of view of royal or government-created corporations, the clause must be considered as wholly valid. If the government chooses to erect a concern of this sort, and has sole power of creation, it may, if it choose, grant thieves' licenses to directors. Regarded, however, as a private contract sanctified by proper formality, such a clause becomes subject to all the equitable and common-law rules requiring the agreement to be in line with public policy.

Illustrations might be multiplied. It is, perhaps, sufficient to say that under the contract or continental theory, *an advance is made toward that safety and certainty of stockholders' rights which is essential in the further development of the corporate mechanism as an instrument for applying capital to economic ends.*[3] (Italics supplied.)

The law by statutes and by court decisions lays down a method of procedure and of practice which may be followed

[2] Gray v. Portland Bank (1807), 3 Mass. 364.

[3] *Studies in the Law of Corporation Finance,* pp. 23-25.

to the letter and without the spirit, as is too frequently the case, or which may be followed in both the letter *and* the spirit. This latter class produces and maintains the "better corporation" from the standpoint of this book. It is my belief that the better corporation is easier to finance, and far more profitable to all concerned than any other kind ever was or could be. I am aware that this picture is the exact opposite of a popular portrayal of corporation law. Main Street regards the corporation lawyer par excellence as located on Wall Street, and plotting every form of trickery to evade the true purposes of law, using methods too obscure and too devious to be understood. I have practiced corporation law in the Wall Street district for a number of years and have been brought into daily contact with its leading corporation lawyers, and I have yet to discover any peculiar predilection on their part for trickery or unfair dealing. In fact a large part of their time is spent in trying to discover and to comply with the true meaning (if any) of the constantly increasing new laws which Main Street through its legislators is helping to inflict upon the country. I don't suppose we are any more honest than the ordinary run of men, but corporation law, especially as applied to the large and active interests, is too open a field and involves too constant inspection from too many sources to be a good field for trickery. Certainly you wouldn't get away with anything so crude as short measure, putting all the good fruit on the top of the basket or slipping a stone in the load of hay.

To sum up the matter I don't think Main Street has any right to criticize Wall Street in matters of corporate finance, law, and practice, and I don't think Wall Street has any right to criticize Main Street in matters of produce, merchandizing, or manufacture—in fact, I don't think it does.

Getting back to "alleged" Wall Street trickery, I have found that the only kind that exists to any appreciable

extent is that practiced by interlopers or hangers-on, by those who imitate Wall Street methods, by natural rogues, frauds, and rapscallions, who either cannot afford to pay the rent for very long or are soon discovered and sent to the penitentiaries. Wall Street financial houses, the banks, and trust companies are established on firm foundations of honesty and fair dealing, constantly under guidance of counsel of the very highest type. Their interpretation of corporation law is in large part my inspiration for here recording what I believe to be the fundamentals or a philosophy of corporation law and practice. For the most part these involve the mere application of common honesty and plain dealing. This will disappoint those who are looking for some novel plan or new "dispensation," but after all there is utmost skill in common honesty. In actual practice it intrigues, perhaps, because it is so often unlooked for, and it is always surprising how well it succeeds.

Books relating to corporations may be divided into two general classes: those relating to the legal requirements of organization, management, etc., the corporation law textbook; and those books which direct attention to accepted methods of finance, of management, discuss abuses of the corporate form, and often suggest legislative reforms of various kinds.

This book proposes to strike a new course—to discuss, to give examples of, and sometimes to recommend methods by which the purely legal requirements may voluntarily be enlarged upon and improved. Many of these methods are now in use by some corporations. It is submitted that voluntary adoption of these better practices will benefit:

(1) the promoter, who is thus furnished securities easier to sell;
(2) the investor, whose better corporation should ultimately provide larger and more certain profits;

(3) directors and officers, by the closer coordinated help from employees and stockholders;
(4) the public generally, because of improvement in its greatest assistant in present day business.

The argument sought to be stressed throughout is the invocation of a new attitude toward the stockholder, by which it is expected that the typical stockholder will awake to an enlarged participation in the corporate activities, will more frequently attend meetings; keep in touch with corporate affairs; make constructive suggestions; and bring increased business to his company—in short, will cease to be an indifferent nuisance to management and become a valuable ally.

The means by which this is to be brought about is first through an understanding of the deeply fundamental character of the stockholder's legal rights and their intensive usefulness to the corporation as well as to the individual; the advantage of interpreting these rights in the broadest sense of an improved business morality, seeking to conform with *both* the spirit and letter, and not alone the letter of the law.

Further and continued study of these rights may develop new, helpful points of view. Says Dr. Henry W. Ward before the Rand School of Social Science:

> The absentee shareholder has replaced the absentee landlord as a silent partner, with his claim on future production. Dividends have succeeded to the position of advantage, formerly occupied in Europe by rent, and have extended the boundaries of that domain. Property becomes more and more a claim to income and less and less the control and use of things.

The next consideration is a study of the pursuits, station in life, and, if possible, the character of the stockholder. A study of the wide distribution of stock, of customer, of

management, of employee ownership, and the character of the average—the small stockholder—leads, I believe, to inevitable conclusions respecting the manner in which these stockholders should be treated in order that real interest in their corporation may be aroused and sustained.

The details by which this is to be accomplished consist in providing as simple a corporate structure as possible, using an appropriate corporate name, using every possible legal safeguard for the stockholder, welcoming the new stockholder, corresponding with him on a human basis, as frequently as possible, giving encouragement to examine the corporate property, to attend and participate in stockholders' meetings, rendering informative, comprehensive, and easily understood reports—in short, bringing the stockholder into as much active and cooperative participation as possible.

Generally and briefly stated, the aim and purpose is to consider methods and practices proposed to *protect the stockholder, use the stockholder, and help the stockholder.*

Chapter II

FUNDAMENTAL PRINCIPLES OF CORPORATION LAW

Corporation law is a composite of constitutional law and statutory law and their handmaid, construction; also procedure (evidence, pleading, and practice), contract, agency, crime, tort, and the principals of government.

For the purpose of this book it is useful at the outset to note that all of this law has two phases: the purely public in which the state has an interest of its own; and the private phase—which merely seeks to regulate the conduct of individuals among themselves. In the first the state *commands;* in the second it *prescribes.* This division is thus described in *Trade Morals,* a book by Edward D. Page:

> We must not forget that there are two varieties of law: the private law which is supposed to be declaratory of folk-custom, and prescribes the relations of citizens to one another; and the public law which prescribes the relation of the citizen to the state. It may be said that private law is declared for the convenience of the folk-group; but that public law is expressive of its will.

By statutes the state sets forth the steps necessary to be taken to secure the corporation's charter or certificate of incorporation. Everything is in writing; the charter and all amendments thereafter made are a matter of public record. Throughout the operation of government there must be a record; certainty and protection depend upon it; wherever the state prescribes this record for certainty and protection, there this record cannot be waived. Wherever this record is required, nothing but realities will satisfy it. The by-laws and minutes of most corporations are not a mandatory requirement of law—but directory—and therefore the keeping

of them and their form is left to the parties in interest, without interference by the state. The state not being a party, provisions of law relating thereto may be waived.

The certificate of incorporation is prepared by the applicants, and thereby at the very outset is invoked a great principle of construction generally not set forth in the statutes themselves; namely, the rule: "Ambiguity or doubt arising out of terms used is construed against the party who has selected them."

Another and far-reaching principle is invoked because corporations for profit ask for their charters. The *request* in contract law is of great significance; in corporation law it has its most technical applications. To illustrate: Because the municipal corporation asks for or requests a charter this is made the basis of charging it with liabilities, like the liability to another for negligently kept or constructed streets or improvements or works. But the quasi-municipal corporation, such as counties, townships, and school districts, is an organization imposed, *without request,* by the state as a governmental establishment, and consequently it has a most limited liability.[1] The liability of these depends upon the express words of a statute. These liabilities are strictly statutory, and the remedies prescribed for such liabilities are strictly taken;[2] the remedy prescribed must be strictly pursued.

The preëmptory requirements of the state are questions of public policy—"that regard be had for the public welfare is the highest law." These requirements concern the entire public and are never less. These matters are essential for the status of the state's fictitious persons; they are fixed for the state and therefore for the whole public, and

[1] Barlett v. Crozier, Williams v. Hingham Turnpike Co., 3 Hughes' Grounds & Rudiments of Law.

[2] Sutherland Statutes 153, 720; End. Statutes 154, 464, 467.

cannot be waived or contracted away. Of what concerns the state—the public welfare, public policy—there can be no estoppel, for there can be no estoppel where there is lacking the status, the power, the authority, the jurisdiction. One cannot contract in forbidden relations; to the illegal contract there ever applies the rule: "Where both parties are equally in fault, the condition of the defendant is preferable." Such matters are out of the law, and may well be called outlawry, and this estoppel, ought not to aid. Of illegal matters between contracting parties the state creates no court to entertain jurisdiction.

Reason and convenience are back of each of the state's requirements respecting the corporate structure. Let us briefly consider them from this point of view.

1. *The name.* It is clear that a corporation, being a fictitious person, must have a definite title of public record.[3] How else can it be identified? To hold title to property, to sue and to be sued, its name must be definite; *i.e.*, only subject to change in the manner provided by law. That the name should imply incorporation, that it should not contain the words "bank," "trust company," "insurance," etc., unless it is incorporated for these purposes and therefore subjected to extra regulations, is a protection to the public based on necessity. That the name adopted be not the same or similar to one already recorded, is a rule which must always be respected; must be clear—otherwise there is confusion in suing or getting service of process upon the right party—or there is the palming off of one concern's goods on the public by one corporation getting the results of the good will of another. Reason dictates the limitations on the right of a corporation to use trade titles, abbreviations, nicknames,

[3] The name is an element of the corporation's existence. American Steel Foundry v. Robertson (1926), 269 U. S. 372, 46 S. Ct. 160, 70 L. Ed. 317.

etc., in addition to its legal title. So long as such additional names do not offend the fundamentals stated, *and* the *full legal title* is always *present,* identified with the additional titles, and so accessible without confusion to any person who wishes to sue the corporation or to serve it with legal notice, what harm is done by the use of such names?

2. *Location.* For certainty of location for service of process for legal notices, the state commands that the location of the "registered" or "principal office" [4] within the state be set forth in the articles of incorporation. It leaves choice of this location to the corporation, and upholds it as binding even when the location is artificially selected for the purpose of securing a lesser tax rate than that imposed by the state, country or city in which the corporation does most of its business.[5]

3. *Purposes.* It is of utmost importance to the state that the purposes be stated in the charter. It is a prerequisite to determining that such purposes are lawful and within those properly allowed to the class of corporation being organized. Both necessity and convenience dictate that corporations of various classes be kept within their respective purposes. Business corporations may not act as banks or insurance companies, etc. Banks or insurance companies, etc., may not be allowed to indulge in the more speculative activities of industrial business. But when classification does not require incorporation under separate laws, we may have almost all kinds of corporations in one. All depends on the powers conferred upon them, and also on what construction may add to those powers.

4. *Capitalization.* The nominal amount of authorized capital, number of shares into which divided, and classification of shares, must be stated in a corporation's incorporating

[4] The Uniform Corporation Act, recommended by the American Bar Association, uses the term "registered office."

[5] Stanton v. State Tax Commission (1927), 117 Ohio 436, 159 N. E. 340.

papers. The state's imperative interest in this matter is because the capital of the company is a sort of substitution for the otherwise individual liability of shareholders. If credit is to be based thereon, it should be of public record. In highly policed corporations—banks, trust companies, title and insurance companies—the state sees to it, that certain minimum capital is subscribed, paid for, and maintained. In the case of the ordinary corporation the reality of money capital has become largely nullified by the practice of payment by overvalued properties and services and more recently by the use of no par value shares. The state's interest in "capitalization" of the ordinary corporation seems to be on the wane. This is in accord with the growing business practice of giving no credit to a corporation on the basis of its authorized capital. Balance sheets—up-to-date financial statements—duly signed under laws imposing criminal penalties for misstatement therein, supply the intended purpose of "authorized capital," in so far as creditors are concerned. The shareholder must still rely on the charter for the primary and controlling statement of his relative fractional, preferential, or deferred interest in the corporation's capital.

The foregoing—name, location, purposes, capitalization—fix the corporation's "identity and individuality." "Until an amendment is made in conformity to law, these designations are unalterable and establish the status of the corporation with respect to these various questions." [6] They are matters which concern the state directly and cannot be waived.

The corporation having come into existence, matters thereafter have to do with *corporate behavior*. How far is the state concerned in this? In its banks, trust companies, financial companies, insurance companies, railroads, and pub-

[6] Stanton v. State Tax Commission (1927) 117 Ohio 436, 159 N. E. 340.

lic utilities it is particularly concerned, its interest depending upon the peculiarities of each activity and the likelihood of abuse. In banks and trust companies the state is anxious that capital and surplus shall be as actually represented—that loans shall only be made within limits of relative safety. In the insurance company the state is interested that capital shall be kept unimpaired, and is concerned with the terms of the policies it issues. In railroads and public utilities the state's interest centers upon safety of operation and fairness of rates. The state's peculiar interest in these corporations is the measure of the extent of unwaivable standards which it sets and the extent of policing, deposit of securities, reports, and investigation deemed necessary to enforce the observation of these standards. With the ordinary business and manufacturing corporation the state today is content with the enforcement of a statement of the things which have been roughly outlined, and the policing incident to the issuance of securities—commonly in the form of "blue sky" laws.

Outside of the foregoing there is set up more or less elaborately by statutes and quite extensively by departmental rulings, attorney generals' opinions, and court decisions, a vast body of law, more in the nature of regulations than otherwise. This body of law is the composite known as corporation law. The provisions of these laws for the most part, not being of direct concern to the state, are waivable. The state indicates a policy deemed to be beneficial to the corporation—to its stockholders and creditors—and being only for their benefit these requirements may be waived. For instance, statute may fix sixty days' notice for the holding of a special meeting of stockholders to consider an increase of capital stock, but this notice may be waived by all the stockholders. The law contemplates an annual election of directors, but if not held the old officers hold over until their successors are chosen. The state in effect says, "We think you

should hold an annual meeting; but if you stockholders do not insist, we don't care."

The laws relating to corporate conduct although often statutory are actually based on broad rules of general law. Consider for a moment how far principles of agency are discussed in corporation law—for instance, the principle "What one does through the hand of another he is considered as having done himself"; also "Let the principal respond," and "The hand that gets the benefit ought also to stand the burden."

A corporation itself being intangible must necessarily transact all its business through agents, these agents having varying authority and powers. The various agencies thus set up constitute a sort of check upon one another, like balance of power in government. The board of directors derives its power to contract for the corporation through its charter and its by-laws. These may set limitations on the "scope" of its agency. The power of the president will be defined in the by-laws and limited or directed in a resolution of the board of directors. A sales agent's authority may be contained in an agency contract, or in letters, or by word of mouth, or by a long-continued course of dealing acquiesced in by the corporation. At all times those who deal with a corporation must bear in mind the rule *"Beware of the agent's authority,"* just as a buyer must not forget the maxim "Caveat emptor," ("Let the purchaser beware"). That is why it is customary for transfer agents to require the corporate owner of stocks to submit a copy of the by-laws and a resolution of directors authorizing the transfer of the stock owned—also the reason for a bank accepting a corporate account only upon submission of a resolution of the directors appointing the bank as a depository and designating the officers authorized to act and to sign for the corporation. Others well informed in corporation law are adopting the

practice of demanding a copy of resolutions showing the authority of the corporate agent.

The tort liability of a corporation likewise depends upon principles of agency—"Let the principal be responsible," and "Who gets the benefit should bear the burden." Wherever the principal has an interest, within that the contracts and the torts of the agent are those of the principal. This is illustrated in a case where cattle escaped from a car, and the station agent engaged a young man to round up the fugitive steers. In this service the young man, without permission, took his father's saddle horse, which was gored by one of the steers. For this damage the father sued the railroad and recovered.

A case less extreme in the application of the rule is where the conductor made himself objectionable to the young lady passenger who refused to bear with silence a kiss forced upon her by the conductor. For this she sued his principal, the railroad company, and received from it $1,000 damages. These cases sustain the view that where the corporation has an interest, there liability attends. The corporation was interested in regaining possession of the cattle; the railroad was obliged to protect passengers in its cars, and especially from the aggressive conduct of its employees.

Equity principles pervade corporation law. The universal principle "One cannot at the same time be the person acting and the person acted upon," should always be respected.[7] In procedure this rule is expressed thus: "No man can be a judge of his own dispute." In corporation law we find it expressed thus: "No one can act where his integrity and his interest are in conflict." In all matters in which one is interested he cannot vote nor in any way participate. This is

[7] Keech v. Sandford, Rumford Market Case (1876), Selden Cases Chancery 6122, English Report 627; Michaud v. Girard (1846), 41 Howard (U. S.) 503.

the rule which places limitations on the right of directors to vote stock to themselves in payment for properties or services, or to sell properties to, or make contracts with, the corporation. Only when such dealings are made independent of the vote of the interested director are they valid. Many jurisdictions have adopted the procedure of treating all such contracts as voidable, the interested director having the burden of proving their benefit to the corporation.

The transfer and registration of capital stock involve many equitable considerations, such as attend the *bona fide* holder. This rule is often under consideration: "Where one of two equally innocent persons must suffer from the fraud of a third, the one who first trusted must first suffer."

Estoppels are of equitable origin. They are frequently applied in corporation law. I have in mind an instance where associate counsel printed on the face of the stock certificates issued by a manufacturing corporation, the amount of stock which had been issued for good will of the concern acquired, also the amount of stock issued to the promoters for their services. This was in order that these matters must surely come to the attention of purchasers of stock, and so that failure within a reasonable length of time to make objection thereto would work an estoppel against them. Those who seek application of principles of estoppel through the contents of minute books should bear in mind that directors' minutes are not always accessible to stockholders, also that the reading of those minutes at subsequent stockholders' meetings may not estop those who do not attend the meetings.

The freedom of corporate action outside and beyond specific limitations of law is frequently overlooked. I have a statement of this situation prepared by the originator of a number of novel and successful methods of corporate organi-

zation and finance, particularly in the field of industrial loans—namely, Colonel Clarence Hodson. Colonel Hodson presented a typewritten copy of his statement to the writer several years ago, suggesting its publication in such altered form as I might see fit. Here it is in full without change of a word:

> Every corporation is entitled and free to use and apply any recognized rule or method in organization methods, procedure, finance, accounting, business practice, and dealings with the public and public officials, as well as with its own stockholders, creditors, and customers according to the discretion of such corporation, exercised under its charter, thru its directors, officers, and agents, except as forbidden by law or public policy, provided the private or public rights of others are not interfered with or violated. Nor is it forbidden because a particular act or plan is unusual in general practice. The following of precedents is recommended but is not compulsory, if not beyond the lawful powers of the corporation expressed or implied in its charter and the laws applicable to such corporation.
>
> Both in the adoption of principles and application of details there is left a considerable discretion for each corporation to choose for the administration of its own affairs within the law. Corporations, like individuals, are presumed to be actuated by selfish impulses for their own advancement and gain thru the employment of its assets, both tangible and intangible.

Before we leave this subject of corporate freedom, let us add the following statement by the Supreme Court of Missouri: [8]

> Where corporations are not restrained by their charters they may adopt all reasonable modes in the execution of their business which a natural person might adopt in the exercise of similar powers.

Some states, as a matter of practice, permit insertion in the certificate of incorporation of provisions enlarging or changing or regulating matters intended for the greater safeguarding of investors. No doubt this practice can be largely relied

[8] Henning v. United States Insurance Co. (1871), 47 Mo. 425.

upon in providing ways and means for voluntary protection of the stockholder. The new corporation act of Louisiana, effective January 1, 1929, is very explicit in this regard. Among things which the articles may contain, section 3, II (c), permits

> any provision creating, defining, dividing, limiting or regulating the powers of the corporation, the directors, or the shareholders, or any class or classes of shareholders; or any other provisions for the regulation of the business and the conduct of the affairs of the corporation, not prohibited by the act or the laws of this state.

Reference has been made to a few leading features of corporate law as based on general principles in order to widen the vision; to establish conviction that the corporation rests upon the same foundations of long-tried usage, as do the other incidents of commerce; that consideration of public welfare, necessity, and convenience must always and forever be kept in mind as furnishing the background and the vindication upon which every corporate act must eventually rest. We should never forget the wise direction "to prove all things and to hold fast to that which is good."

It is not customary to consider or to discuss corporate law in this manner. Our common practice is to lay a finger on the "exact" words of the charter, by-laws, or statutes which precisely answer our question. If this is not available and construction must be resorted to, then we try to find a decision by a court of the state whose laws are under consideration which has considered our question in a matter on "all fours" with our own. If this is not to be had, then we look through the digests, citators, and textbooks for such a case decided by a court in a state having a law similar or nearly similar to the one that troubles us. If this is not securable, then we resort to such general interpretation that any law writer may furnish. Finally in the absence of all other help, we resort to thinking the thing out for ourselves and then

we apply rules of construction, public policy, business usage, and convenience to our problem. In other words, we want our thinking to be done for us—to be ready-made—to be cut and dried.

In the main this is wise, even if adopted more from laziness than from a motive of perspicuity. Precedent is valuable because it is apt to be followed by those who come after, convenient and the easiest way, and principally because the white heat of litigation nearly always has developed the light under which truth will be found. But so customarily are these precedents blindly resorted to, that in time they become a multitude of bewildering instances.

Like all good things the corporation has been abused. The cure for these abuses rests, I believe, in a recurrence to fundamentals, also in adoption where applicable of new practices many of which are not yet law, but are helpful in carrying out the true purposes of corporate organization in the broader sense of everyday experiences.

The fundamentals to which recurrence is made in this book, or at least some of them, appear at first to be too simple to require statement. Nevertheless, they are daily being violated or forgotten. That is excuse enough for repetition.

Stress has been laid on the doctrine of waiver, the practice by which one may forego the provisions of law enacted for his benefit.[9] It has been shown that this doctrine does not, cannot apply where the state has a direct interest. Other limitations upon waiver are that the matter waived must relate to an existing right and must be one in which the parties to the waiver are the only parties having an interest. For example, a stockholder or director may waive notice of a particular meeting, but he cannot waive the right to notice of all meetings to be held in the future. What is the reason

[9] Hull v. Hull (1916), 172 N. Y. App. Div. 287, 158 N. Y. Supp. 743.

for the distinction? I apprehend it is this: The stockholder and the corporation or the director and the corporation are the only parties interested in the notice of a particular meeting. The waiver itself gives notice that a meeting is to be held, where it is to be held and its purpose. The stockholder or director, as the case may be, in effect receives actual notice. He only dispenses with the formal notice and especially the requirement of the time elapsing between the receipt thereof and the date set for the meeting—these are only matters of convenience personal to him. The state's policy and interest has been satisfied, inasmuch as the stockholder or director has been given the opportunity to attend.

But suppose waiver of notice of all future meetings is attempted. If given effect the law of notice would be entirely dispensed with. Meetings could be held surreptitiously—opportunities for fraud would be developed—the whole scheme of government and management would fail.

Take another example: By court decision there has been evolved the doctrine that upon an increase of capital or before stock previously authorized but withheld from sale is offered to others, present stockholders must be given the right to subscribe to such proportion of the new issue as will maintain their present fractional holding. This is known as the stockholder's preëmptive right and is founded upon the theory of protection to his relative voting power. A leading case[10] in which the rule is laid down points out that the stockholder may *waive* this right. The waiver of such right with respect to a particular increase presupposes that the opportunity has been afforded, that the stockholder having in mind the size of the offering and the exact effect it will have on his relative voting power, in effect chooses to forego his opportunity. The safeguard has been afforded. The policy of the law has been satisfied. But what would be

[10] Stokes v. Continental Trust Co. (1906) 186 N. Y. 285, 78 N. E. 1090.

the effect of a general waiver of all future preëmptive rights? Nothing short of dispensing entirely with the state's policy; it is interested in this as a third party. The attempted general waiver would be ineffectual.

So likewise consider the right of the stockholder to participate in deciding the question of a sale of all the corporate assets—to take exception to personal dealings of a director with his corporation, with the usual burden of proof upon the interested director to show authorization of the dealing or offering by a majority of the directors, excluding himself from the count of such majority and of the rule requiring proof by him that the contract is fair and beneficial to the corporation. These are matters of protection to the stockholder and, as in each case which comes up, with information available of the particular matter and its effect, *waiver* by the stockholder is in effect approval. But take away all opportunity to object by general waiver, will the law thus permit its policies to be frustrated? Add to these last three subjects, (1) abrogating preëmptive right, (2) necessary consent on sale of entire assets, (3) rule limiting rights of directors in dealings with his corporation, a fourth subject, namely, (4) the non-voting common stock (which by the way was originally sustained with respect to preferred non-voting stock, partly upon the theory of waiver), and we have before us the four horsemen of evil portent now darkening the corporate skies and so roundly, and I think properly, denounced by Professor Ripley.

So-called liberal charter granting states presumably authorize dispensation of former policies of protection and permit insertion in certificates of incorporation of provisions which on their face would in effect operate as general waivers in advance in the manner just herein stated to be ineffectual. I say *presumably* these states have done this because they have enacted statutes to this effect. But statutes expressly

relating to corporations do not express the entire will of the state with respect to the matter. Policies with respect to laws in general, constitutional provisions perhaps, criminal provisions against fraud have to be considered. Corporation law is not a thing apart but interacts with and forms a part of all law; in fact, it is a composite.

Certainly in all cases of fraud none of these provisions will be a defense. The protection which the state owes to its citizens and inhabitants against crime in any form is greater than a rule of corporate conduct presumably enacted for mere convenience of the corporation itself. The principle that "no one can act where his interest and his integrity are in conflict" is the same rule which limits the dealings of a trustee with the trust estate and with the beneficiary of the trust—is the principle which limits a director in his dealings with his corporation and with its stockholders. Many believe that this principle is fundamental and even superior to written constitutions; in fact, that it is one of the ingredients of a prescriptive constitution, which goes back of all other law furnishing criteria for their correct interpretation.

The reader who desires a more extended review of the essentials of corporation law is referred to the Uniform Business Corporation Law recommended by the American Bar Association. This, with its annotations, constitutes a comprehensive basis for comparison of the various state laws now in existence. The text of the uniform act to a considerable extent follows the new Ohio corporation law. Complete definitions, reduction to statutory form of common-law principles applicable to corporations, the elimination of doubt with respect to various troublesome questions, compulsory application of cumulative voting to election of directors, and creation of fiduciary liability upon those having voting power toward the voteless stockholder are some of the features of special interest.

From the foregoing outline of fundamentals of corporation law, the following important deductions are made:

(1) That corporation law and practice is in reality based upon interactions of all law and is entitled to the respect due to custom evolved from the experience of ages.

(2) That these laws and practices should be followed in the spirit of their necessity and intensive usefulness.

(3) That outstanding and fundamental and back of it all is the state and the welfare of the state, and that this phase of every corporate legal problem must be considered first. If it is a matter in which the state has an interest, then the provisions of law relating thereto are mandatory and cannot be waived. If such interest does not appear, then the parties—stockholders, directors, officers, creditors, whoever they may be—may treat the provisions of law relating thereto as directory—may vary the provisions thereof to meet their needs, provided they act within the limits of mandatory law, and may waive the requirements of law set up for their benefit.

Chapter III

THE STOCKHOLDER'S RIGHTFUL POSITION

After the typical corporation is organized and embarked on its career, its contact with the law becomes a ritual—highly formal, legalistic rigmarole. We have the investor's money; now all we have to do is to go through a ghost dance every so often to the everlasting, tiresome tom-tom of the lawyers. It means nothing really, but still we must do it. A moving here and there—a sliding in and out behind some statute.

Well, what of it? Does it harm any one? Why should it be otherwise? The answer, in my opinion, is that there is harm done. It robs the corporate form of effectiveness as a cooperative unit. It should be otherwise in order that investors shall continue to contribute their numerous contributions, not only of money but of thought and work, to the vast aggregations of capital necessary in modern business, and in order that the capital so aggregated shall be conserved and made productive. The routine procedure has brought on the apathetic stockholder who does not care to attend meetings; neglects to sign and mail proxies even though already prepared and with prepaid postage for return; even fails to exercise or to sell rights, with immediate and direct financial loss. Into this situation comes the wider distribution of securities—the customer owner, the manager owner, the employee owner of stock—and these things are encouraged and eagerly looked forward to as the advent of a better day for the corporation. And why?

Because such security owners will help sell the corporate products or service—will create a better feeling toward the

corporation and politically have votes and consequently direct political influence. The employee stockholder is expected to give better, more reliable, loyal, and continued service. And all this is to be in the face of non-entity treatment by the corporation! It is so intensely illogical—such expectations —that it seems impossible. Especially is a broader view of the stockholder's rightful position needed if customer and employee ownership is to bear full fruit. Is it to be supposed that such purchasers of stock are solely actuated by desire for dividends or increase in stock price? Hardly, limited as they are to relatively small amounts of investment. Small owners would find it much more convenient to have the cash in a savings bank easily available for emergency. Surely such purchases are principally made as a matter of pride. They want to feel that they are part owners of the business with which they have daily relations—the thrill of participation in the creation of new wealth. Nowhere do I find any reference to pride of ownership in corporate stock. It is high time that an appraisal be made, values weighed, and properly ascribed.

When Professor Ripley drew attention in the *Atlantic Monthly* to disfranchisement of the common stockholder, great public interest was aroused. The Stock Exchange announced that corporate set-ups containing non-voting common stock would at least be looked upon with disfavor. Professor Ripley stated in his book, *Main Street and Wall Street,* that so thorough had been the condemnation, that "voteless stock" was now dead and would never again raise its head. Personally, I doubt this. The voteless common stock is still with us. Professor Ripley, pessimistic in most things, is here too optimistic. However, what interests me is the attention given to his protest in behalf of the stockholder. There seems to be lurking somewhere a general recognition that the stockholder's relegation to the back of the picture is

wrong. There is a faint hope that something will happen to correct the false position. The correction must come, in my opinion, in a general thorough change of attitude toward the stockholder. Disfranchisement is a mere negative incident, important to be stamped out but still a mere incident, compared to a general change of habit of thought.

A new positive attitude of cultivating the stockholder, of setting up new safeguards for him and of arousing and of sustaining his active interest is what we need. There must be an awakening to the truth that his rights are fundamental, fitting into and making a part of all law—not mere transitory statutes, but deep-set matter forming the foundation of all things. From such change of thought will come compliance with corporation law as a means of conserving and improving business. Requirements of law will then cease to be mere "mechanics" and troublesome waste of time. They will be looked upon as aids to business.

Alleged apathy of stockholders is usually due to lack of contact between corporation and stockholders. Failure to secure the registration of one's share is, of course, primarily due to the non-payment of dividends. But may it not also be due to the fact that the corporation fails to furnish illuminating reports, and otherwise fails on its part to furnish reasons for the desire of contact on the stockholder's part? The result is that the corporation's list of stockholders does not contain the names and addresses of its present owners. Such stockholders do not, therefore, receive notice of rights on reorganization, etc. It is not apathy in the matter of exercising his rights to purchase new securities on reorganization or otherwise, but apathy due to his general belief that he expects nothing from his corporation. An example comes readily to hand. The newspapers report (September 6, 1928) that in spite of extensive publicity for more than three years regarding the receivership of the Chicago, Milwaukee & St.

Paul Railway, many stockholders and some of the bondholders are apparently unaware of the situation. Kuhn, Loeb & Co. and the National City Company, which acted as reorganization managers, sent letters to registered owners of undeposited shares calling the situation to their attention. Many of the registered shareholders are not actual holders but have sold their shares and the present owners are unknown, while in the case of the bonds, which are payable to bearer, the owners are wholly unknown to the reorganization managers. Six thousand shares of preferred and 15,000,000 shares of common had not been deposited, although there was an equity, after payment of assessments, of about $49 for each share of preferred and $33 for each share of common, according to market quotations.

The present-day stockholder's lack of participation in the business is to be regretted, because it takes from him the full thrill of the romance of business to which he is entitled. This is a point, as I have just said, which is generally if not entirely overlooked. All the critics of present-day methods seem to have in mind that the stockholder only wants two things—dividends and an enhancement in the price of his stock. Any improvement in laws or in practice are merely recommended as a means of more adequately assuring these things. The idea that the stockholder likes to feel the glory of achievement and of power—the romance of business [1]—so frequently ascribed to captains of industry as the chief driving and animating force of their careers, is completely ignored.

[1] "It is almost trite to observe that Big Business is the romance of contemporary America. It is the lure to the adventurous. It is, strange to say, the escape from the humdrum and boredom of standardized amusement. It invites to its hazard and rewards those spirits which in earlier days would have ventured into Araby or sailed their galleons on the Spanish Main." *Outlook and Independent*, February 20, 1929.

Certainly one of the greatest attributes of property is pride of ownership. A finely engraved stock certificate stowed away in the safe-deposit box, formal reports, notice of meetings—is this enough to stimulate that pride? Hardly. It is too remote from any tangible connection. Visits to offices and factories, dinners, samples of the company's product, a pass now and then to a theatrical or moving-picture production sent to stockholders by amusement corporations, not all at once, but in groups—these are mere hints of what can be done to make a stockholder feel that he has connection of ownership with his property. These are things that will stimulate his pride, because they make him feel in touch with actual activity and achievement of the business. Surely it is only dividends and dollars and cents value of stock when corporate control or management by its aloofness, indifference, or high hat, makes it so. How about making the stockholder a partner in the romance, and then see how much he will help swell the profits? Who will deny that it is the desire to make money that keeps the wheels of all industry turning? But the turning must be as pleasant as possible and work itself may be the greatest of all pleasures.

Pride of achievement is every day referred to as the actuating force behind the activities of prominent business men. May not the small stockholder be made to realize a proportionate participation in these things and a new impulse added to his interest in the corporation? Typical instances of the force outside of mere money getting are related by Earnest Elmo Calkins in the *Atlantic Monthly* for February, 1928:

> The interest of creating an entity out of a great corporation,—something more than a mere money-making machine,—guiding it in making industrial history with chemists and engineers as pilots, invoking advertising to make the public a sharer in its triumph, actually adding to the sum total of human happiness, as happiness goes in these days, offers more real thrills than any of the old-fashioned professions can offer.
>
> Colonel Du Pont, with wealth and corporations to satisfy any mere

money-grubber, buys an old and run-down paint factory, and in a time so short it sounds like an Arabian Nights story, is doing one-third of the paint business of the country.

Cyrus Curtis developed three enormous magazines, each a leader in its field, and then moved out and into the moribund *Public Ledger* and began his business life all over again. And when the *Ledger* showed signs of making good he moved over into New York and started doing the same thing with the New York *Evening Post*. It would be absurd to suggest that Curtis needs more money. This all means that business as it is now conducted is the supreme field of endeavor, calling for every quality of mind that success in the most idealized profession demands,—brains, energy, and imagination,—and that, as such, it draws men to it for the sheer love of doing it.

The thrill, the glory, the love of achievement, give the stockholder full participation in these things—dividends in the intangibles—and see how it will lift him from his lethargy, and make him the greatest help to the business. It only takes a change of attitude to start, and actions will follow that will bring this about.

Full realization of ownership will come when small stockholders identify themselves with their companies. A writer in a popular magazine is reported in the New York *Times*, November 22, 1925, to have said: "Our company! Our service! Our customers! That is the way people begin to talk after they become shareholders, not only to the officers when they come in to ask questions but to neighbors who criticize the company." Perhaps this sounds a bit overdrawn or ridiculous, but there is something incongruous, anyway, in associating a product or a business with an individual.

"I doubt," continued Mr. Donaldson, frankly, "if all told, I have as much as ten million dollars in the world."

Lord Emsworth swayed like a sapling in the breeze.

"Ten million? Ten million? Did you say you had ten million dollars?"

"Between nine and ten, I suppose. Not more. But you must bear in mind that the business is growing all the time. I am Donaldson's Dog Biscuits."

"Donaldson's Dog Biscuits! Indeed! Really! Fancy that!"

"You have heard of them?" asked Mr. Donaldson, eagerly.

"Never," said Lord Emsworth, cordially.

"Oh! Well, that's who I am."[2]

Continuing this vein of humor may we some day hear a conversation like this:

"Who are you?"

"I am Armour's—that is mostly—but partly I am American Tobacco."

"Oh, I see; you are the 'Ham what am.'"

"Not exactly. More precisely speaking I am a smoked ham."

Appreciation of the fact that great help can come to a corporation from its stockholders is occasionally shown by those companies fortunately in a position to choose those whose subscriptions it will accept.

Applications had been made for more than the capital stock of a new bank to be located on Fifth Avenue, New York. Questionnaires were sent to all subscribers to determine those who will help the bank in business, the distribution of stock to be made on the basis of the answers received.

The questions asked were:

1. What is your line of business activity?
2. In what corporation or firms do you hold office?
3. Would you be willing to open an account with the company within thirty days of its opening? It would help the Allotment Committee if you would indicate roughly the probable average balance you would carry with the company.
4. Would you be disposed to influence any of the firms or corporations with which you are allied to open accounts with the company?
5. If you reside outside of New York City, would you be disposed to open a New York account with the company, which practice is becoming common on the part of those who have business in New York City or visit New York City?

[2] From *The Custody of the Pumpkin,* by F. G. Wodehouse.

The paramount position of the stockholder is so little recognized that we cannot leave this point until we have called upon the wisdom of Judge Gary:

The Security Holders. These must be recognized as rightfully in control. Their capital permits the existence, the activities, and the success of the corporation. They properly may and ultimately will dictate the personnel, the governing rules, the policies, sales and purchases, extensions and improvements, rates of compensation to employees, including special compensation or bonus appropriations for merit, terms and conditions of employment, and all other matters pertaining to the properties and business and management of the corporation. After the honest fulfillment of all obligations to others, they are entitled, not only to a fair and reasonable return on their investments, but to all the net proceeds of the business; otherwise they could not be expected to leave their capital in the enterprise in question. It would not long continue active, or even in existence, if a majority of the stockholders remain dissatisfied. They are the initiative, the sustenance, and the life of the corporation. In a discussion of corporate questions, the rights of stockholders are sometimes overlooked or ignored by the public speaker or writer, especially if by reason of inexperience or otherwise he is incompetent, prejudiced, or unjust.

President Charles E. Mitchell of the National City Bank of New York puts responsibility on the stockholder for apathy and lack of cooperation:

We now have 18,402 shareholders, an increase for the year of 2,661. About half of these reside in near-by territory and the balance are scattered over every state of the United States and 37 foreign countries. These shareholders are partners in an enterprise operated for their common benefit. There is scarcely one who during the year cannot use some particular service which the institution offers or influence others to use such service. From a great number we are receiving patronage in many services but there are others in quantity who neglect their partnership responsibility. A shareholder whose attitude is not enthusiastic, whose inclination is not to be helpful, whose business that could be done with us goes elsewhere, is a discouragement to the management. With full gratitude to those who have assisted in our advancement and added to our good will, we take this opportunity of soliciting from share-

holders in general and in particular that full measure of cooperation which we feel is their partnership obligation. (Remarks of the President at Annual Meeting of Shareholders, January 8, 1929.)

The dawn of a new era, of better understanding between management and stockholders and greater cooperation on the part of stockholders, appears on the horizon. This fact is being observed by those in close touch with corporate affairs. The Bankers Trust Company of New York in *Trust Companies Magazine* for January, 1929, says:

> Cooperative thinking underlying our present prosperity is a new conception of industrial cooperation. In spite of increased competition, there is a growing realization of the importance of maintaining a free flow of commercial and industrial information. This is being accomplished by a closer relationship between industries, between government and business, and *between the shareholder and the corporation.* (Italics supplied.)

Chapter IV

THE ERA OF THE SMALL STOCKHOLDER; WIDE DISTRIBUTION

The United States is a nation of stockholders. Wide distribution of stock has always been considered a favorable development. Every one has noticed from time to time newspaper announcement of the number of shareholders in the Pennsylvania railroad and in the United States Steel Corporation. A large number of shareholders is thought to steady the market price for stock. It has new significance with respect to customer and employee ownership. Small average ownership usually means easy proxy control. Wide distribution is of considerable political interest. As distribution increases so that the number of stockholders approaches the number of political voters, stock control and political control will perhaps coincide. When this point is reached many expect that legislators will cease to pass ill-considered and unjustly adverse legislation against corporations, and will advance the interest of their stock-owning constituency.

Wide distribution of stock means common interest of the average person in corporate finance. It coordinates with increased attention from the public press. It demands a popular and easily understood literature relating to corporation law and practice.

In June, 1928, the New York *Times* sent out a questionnaire to corporations whose shares are listed on the New York Stock Exchange. From the answers received, we glean the following:

More than 1,000,000 common stockholders have been added within the past five years.

It was the opinion of executives of corporations making reply that there were three principal causes for the increase: first, the widespread interest in securities of all sorts, and the growing inclination of stockholders to get their securities transferred into their own names and "take them out of the market"; second, the fact that many corporations have given their employees opportunity to purchase their stocks in small amounts, paying for these investments out of weekly or monthly salary; third, the large number of customer-ownership campaigns which have been conducted in the last five years, especially by public utility corporations, which have embraced this method of wide stock distribution as a step in a campaign to secure public goodwill.

Railroads have lost ground so far as common stockholders are concerned, but have gained in preferred stockholders.

Recent word on stock distribution came on September 26, 1928, from Joseph S. McCoy, actuary of the United States treasury. He states that at that time there were about 3,000,000 individuals in the United States who own corporate securities:

The number of stockholders in the United States has increased materially since the war. Business concerns have encouraged employees to buy stock in the concerns they work for on the theory that stockholders take a greater interest in the business.

The old theory that there are at least 15,000,000 stockholders in the United States was based on the outstanding amount of corporate securities, but investigations have shown that some individuals own as much as 500 different stocks.

Mr. McCoy said that city dwellers are the greatest stock buyers and that rural people usually invest their money in road bonds and other county or state securities.

The average salaried person now invests in stock of one kind or another, but usually in the business in which he is engaged.

The vast majority of stockholders are far removed from the millionaire class.

Statistics show that millionaires own less than 7 per cent of the outstanding corporation stocks. These same statistics, however, reveal that about 95 per cent of the wealthy people in the country obtain their income from stock dividends.

There are about 100,000 widows who are solely dependent on stock dividends for their incomes and many orphans are cared for in the same manner.

Mr. McCoy said laborers and low-salaried workers seldom put their surplus money in stocks, but use building and loan associations as a savings medium. He said it was not uncommon, however, for a person with a salary between $2,000 and $5,000 annually to be a stockholder.

He added that his estimate of 3,000,000 stockholders did not include speculators on stock markets. He classed this type of stockholder as one who holds securities on a gamble for profit, while he characterized the other group as stockholders who invested for a savings profit.

In November, 1928, John Moody, president of Moody's Investors Service, said:

More and more the corporate industries of the United States are becoming the property of the public, and more and more are individual citizens investing their wealth and their savings in corporate securities. In my view this new era in America is in its first stages only. The coming decade will witness its expansion and extension far beyond its present state.

The *Outlook and Independent* for February 20, 1929, says:

Great corporations instead of being owned by the few are now owned by the many. And those who own receive the dividends—if there are any. The profits that used to go to the few are now distributed to hundreds of thousands. Theoretically, those hundreds of thousands control the corporations they own; as the millions of citizens of this country control the country's government. . . . Industry now, like government, is facing the perils and problems of democracy.

Democracy is always on trial. It has been on trial in America for one hundred and fifty years—in politics. It is now on trial in industry.

The Beneficial Loan Society, the large and well-known loan company, largely financed by small investors, through its house organ the *Beneficial News,* December, 1928, expresses the opinion that the wider spread of security distribution is due to three things. The first is a departure from the belief that corporate security investment was intended for the relatively few "who were regarded as daring or as enjoying a knowledge of things not meant for the average man or woman. Consequently, there was a hesitance on the part of millions of people to venture into the ranks of corporate security holders. It is commonly said that the floating of Liberty Bonds, during and just after the World War, started the great movement toward bond and stock ownership." Certainly a great many investors received their initiation in that manner.

Another great doubt that retarded the growth of our corporate system was the feeling that existed—and not so long ago—that corporations, as artificial persons created by the state, were "soulless." Today this feeling is being displaced as the number of people employed by corporations is increased, and as it becomes more evident that corporation executives realize that "it pays to render service."

But whatever the cause, the fact remains as expressed by Mr. Moody, that "with the vast broadening of corporate activities" has come a new period of prosperity to the American people.

Widespread distribution is proudly advertised as a corporate asset. Here is an example:

Who is Swift & Company?

Swift & Company is not a one-man or one-family affair. It is a company owned by more than 40,000 people scattered over the face of the globe—forty thousand shareholders with voting powers and a share in the risks and profits of the business.

Most of the forty thousand live here in the United States. But some

of them live in France, some in England, others in the Philippines, Hawaii, Alaska.

Thirteen thousand of them are women.

Nearly fourteen thousand of them are employees.

The average individual holdings are small—about thirty-seven shares apiece.

No one person or family owns a majority of the stock.

In fact, it would take 900 of the largest shareholders pooled together to vote 51 per cent of the stock!

These shareholders are the men and women whose money, in the form of capital, makes Swift & Company possible.

They are jealous of the character and reputation of their organization, proud of what it is doing, proud to have a part in supplying to the world such products as Swift's Premium Ham and Bacon, Brookfield Sausage, Silverleaf Brand Pure Lard, Wool Soap, Swift & Company's fresh meats, etc.

The executives of Swift & Company maintain the high standards of these products as an imperative duty not only to the 40,000 shareholders, but to the public.

The Bell Telephone Securities Co., Inc., advertises:

Among those owning:

A company is known by the stockholders it keeps.

The American Telephone & Telegraph Co., which derives most of its revenues from its investments in the Bell System, includes among its stockholders many of the big and conservative investors of the nation, but it has also an army of small investors. It has more than 250,000 shareholders with an average holding of only about 26 shares.

A lineman in Seattle; a supervisor in New Orleans; a night watchman in Boston; a clerk in Philadelphia—thousands of these telephone workers own stock in the system which they serve.

This is a surety against inefficiency and waste. It is a pledge of safety.

Thus proclaims the Continental National Bank & Trust Company of Chicago:

3300 stockholders.

More than 3300 men and women hold the stock of this bank. The

largest single holding is less than 2½ per cent of the total stock. Three hundred eighty of the stockholders are employees.

The American Waterworks and Electric Co., advertises:

To The Far Frontier

No postoffice is too far away in the purple sage to receive and distribute its quota of dividend checks to the real owners of our American industries.

The investment of hundreds of millions of dollars in the securities of our public utilities, representing the savings of many thousands of people, is one of the most significant economic facts of our day. It is practical public ownership.

More than fifty thousand thrifty people, most of them customers, are stockholders of this Corporation and its subsidiaries. Other thousands own the bonds of these companies.

This is a powerful influence for sound management and prudent financing.

ASSOCIATED GAS AND ELECTRIC SYSTEM

Founded in 1852

51,000 Shareholders in 48 States and 23 Foreign Countries

There are Associated shareholders in every state in the Union and in all the Canadian provinces except three. In 20 states there are 100 or more shareholders each, in 7 states 1,000 or more each, and in one state over 22,000.

This wide distribution of stockholders (1) is evidence of the general acceptance of Associated Gas and Electric Company shares as an investment and (2) adds materially to their marketability.

The Public Utility Investing Corporation proclaims that it has 65,000 investors and that "there are holders of Associated Gas and Electric Company securities in every state in the Union and in twenty-three foreign countries."

Small par values and a large number of no par value shares are important aids to wide distribution of shares. Experience amply demonstrates that the investor prefers a large number

rather than a few shares as evidence of his interest. The smaller unit being within the reach of a wider market facilitates trading. Application of the effect of par value in large amount to hamper and cut down trading and to induce original holders to retain their shares was illustrated by the Carnegie Steel Company, par $1,000 per share. Mr. Carnegie arranged this unusually large par value to effectuate purposes just stated.

With wider distribution of shares today than ever before, $25, $10, even $1 par values are becoming an almost everyday practice.

The National City Bank of New York, on increase of capital provides for 5,000,000 shares of $20 par. Throughout the country banks and trust companies decrease the par value of their shares to $25, $20, and $10. Says *Trust Companies Magazine* (December, 1928):

> There are two prime aspects to bear in mind in analyzing this trend. One is the primary motive of popularizing banking and the appeal to a wider clientele, both as customers and as partners in the enterprise. From that viewpoint the accessibility of bank and trust company stocks to a large circle of investors and patrons is doubtless predicated on sound principle as a means of reconciling the public to larger units, fostering branch banking, and as a leverage for account competition. Experience both in Europe and here warrant such conclusions. The innovation is likewise in step with the great economic changes in corporations and business as well as the wide interest in stocks and investments productive of a new era of co-partnership and diffusion of productive capital.
>
> But there is another side to the matter which provokes differences of opinion among bank managements. While there is not the same inducement or latitude for stockholders to create minority groups or to seek to undermine control, as more often obtains in industrial and other corporation stocks, there have been instances which suggest the wisdom of guarding against such misadventures in banking control. It may be that in the course of a few years such fear will be proven groundless, but there is no doubt that the question of control and of preserving existing poli-

cies, will act as a constraining influence. On the other hand, the results, where wide distribution of shares is obtained, may be so beneficial and substantial that $100 par values may become the exception rather than the rule in banking capitalization.

Insurance companies are also joining the movement to reduce par values. The Ætna companies propose a reduction to $10 per share. Insurance officials generally take the position that wider distribution of stock is desirable. High prices prevent employees from acquiring shares. The consensus of opinion among insurance men is that a split-up of insurance shares immediately leads to purchase by employees and by a wider public, where "financial interest is desirable."

May wide distribution of shares go too far? Limitations and a remedy are clearly stated in a message to stockholders by Alfred P. Sloan, Jr., president of General Motors:

While General Motors was very fortunate in a combination of circumstances which made possible the very attractive plan embodied in Managers Securities Company, the principle involved, in my opinion, may be made available in any institution which is faced with the problem of making its executives stockholders and therefore partners in the enterprise.

The Managers Securities Plan has been so successful that it behooves General Motors to develop a similar plan to interest its future senior executives, for it must be recognized that through evolution those now carrying the great responsibility must necessarily pass out and their places be taken by others.

While discussing the fundamental policies that we are following and the relationship between the Corporation and the members of the General Motors family, I think it will add materially to a better understanding if I briefly outline to you the philosophy of management that we are endeavoring to practice in administering the affairs of General Motors.

Nearly every large corporation has experienced a phenomenal increase in the number of its shareholders during the past ten years. Undoubtedly the end has not yet been reached. Diffusion of corporate ownership is inevitable because as corporations grow in size, they must appeal to the investing public for the enormous sums necessary to carry on and finance

their development. It seems to me, however, there is a point beyond which this diffusion of stock ownership must enfeeble the corporation by depriving it of that virile interest in management upon the part of a group of men to whom its success is a matter of personal and vital interest; and the public interest becomes involved when the public can no longer locate some tangible personality, or group within the business which can be held responsible for the corporation's welfare.

My personal idea is that this situation is well taken care of in General Motors. Ten years ago General Motors had 1,927 stockholders. Today, while a large part of its stock is in the hands of over 50,000 stockholders, the remainder is actually owned by a small group in whom lies the executive management and upon whom may be fairly placed the full responsibility for the success or failure of the institution. I feel it is most vital to the future success of General Motors to insure this condition of management ownership being continued and that the principles herein outlined will accomplish that most desirable result.

This group of men regard the smaller stockholders as full partners in the enterprise, entitled to full knowledge of its condition, its operation, its ambitions—partners just as truly and completely as if each one were personally known to them. This group also has full regard for the happiness, prosperity, and equities of each and every one of the employees in whose hands—some more and some less—rests the success of the institution. It also has regard for the financial success of the dealer, and the service the institution is rendering the public, because public goodwill constitutes an intangible asset of incalculable value. In other words, in my opinion, from the standpoint of all the factors involved—capital, labor, management—this is an ideal situation and is the strongest possible safeguard of the public interest as well.

Under such a principle and such a policy and such a type of organization, no opportunity will be lost to see that the policies are sound and constructive and the management industrious and progressive. The institution will receive all that a personal business should receive in the way of initiative, encouragement, protection, and provision for future needs—all of which makes for growth and success. By this arrangement the advantages of private enterprise are carried over into modern big business without loss of the special advantages peculiar to the corporate form of industrial development.

Broadly speaking, I firmly believe that General Motors, in the execution of these policies, has justified itself not only as an economic and efficient instrument for the production and sale of merchandise, but in its public and industrial relations as well.

Chapter V

CUSTOMER OWNERSHIP

CUSTOMER ownership of corporate securities is not a new idea. Several attempts in the past were notably successful in raising initial capital, and several experiences taught some valuable lessons, most of which unfortunately have gone unheeded.

Customer ownership has received a new impetus from the public utilities. Corporations engaged in this industry have made a notable success in achieving large customer ownership, and have obtained highly beneficial results therefrom. The customer owner is not so captiously critical; his political vote and political influence are particularly valuable to corporations needing public franchises and so highly regulated as are the utilities.

But there is no end to the application in some form or other of coordination of customer with stock ownership. A recent application in my own experience was an invitation to become a stockholder in a newly formed surety company. Members of the bar were sought because of their opportunities in the placing of many court bonds.

In considering the opportunities for customer ownership, consider how far the corporation and its products have become a part of our daily lives. Trade used to be summed up by the neighborhood personalities of "the butcher, the baker, the candle-stick maker," "the corner grocer," and "the village blacksmith." Their places are now taken by great corporations, the distribution of whose stocks makes it possible for nearly every one to take a part in the same industries which he must patronize to supply himself with the necessi-

ties and luxuries of life. Coincidence of stock ownership with consumption of goods opens up new vistas of advertising by which such stock owners will increase their consumption of the particular brand as against those of competitors, and will also become effective advertising agents or propagandists among their friends and acquaintances.

By a mere reversal in order of works the customer owner becomes the "owner customer." The difference is only significant because of the manner of approach. A public utility company's officials look over their list of customers, mark off those who are already stockholders, and direct their efforts toward converting the rest to the idea of becoming owners.

Another company's officials (engaged in the sale of some commodity, let us say) look over their list of stockholders, and ask themselves—how many of these stockholders are customers? If not, why not? The usual company today will have no data whatsoever to show whether they are customers or not. Moreover, they will have no data whatsoever to show what kind of prospects their several stockholders are.

There is no reason, so far as I can see, why nearly every corporation should not send out a questionnaire to its new stockholders, from which the corporation will cause compilations and classifications to be made from which it will at all times be known to what approximate extent and in what directions its several stockholders can help the business. With such data in hand it should go after its stockholders, with the same vigor as their salesmen solicit business of any other prospects. Their own stockholders should not only be sold but be "kept sold" on the corporation's products. It is not only expected that the stockholders will become customers, but they will be salesmen as well for the corporate goods, as far as advertising, saying a good word, boosting the business

is concerned. It is not to be expected that they will normally go so far as to "take orders."

Experience with customer ownership in the financing of a private hospital, the Park West, is reported by Doctor Harold Hays in *Hospital Management,* March 15, 1927:

> The building of a hospital such as this was a very personal problem. It meant it would have to be subscribed for by my friends, patients, and the doctors with whom I was intimately associated. Two or three points I considered of the greatest importance: 1st, to get as many stockholders as I could who would subscribe to from $1,000 to $5,000 worth of stock, rather than to get certain individuals to invest large amounts; 2nd, to interest as many doctors as possible, to make them feel that this was a good investment, and at the same time to firmly impress upon them that they would use the hospital much more if they had money in it. The result of this plan was that I have about one hundred and seventy stockholders, among all classes of people who are advertising the place; and forty-eight doctors own stock, almost all of whom are using the hospital as much as they can.

An early instance of corporate customer ownership contains lessons worth remembering. A meritorious toothpaste, mouth wash, etc., were developed; an attractive trade name was adopted. A corporation with a large authorized capital was organized and its stock was sold in small amounts to dentists throughout the United States. These dentists mentioned the new articles and recommended them to their patients and also helped to induce drug stores to purchase and have a supply on hand. Distribution of the goods spread like wildfire—success was brilliant and it all happened, it seemed, over night. The first wave of success was shared with the dentist stockholders. Though each stockholder did not receive a large amount since his holding was small, the rate was good and gave indications of future enhancement in value of the stock. Enthusiasm grew and orders literally poured into the factory. Then began the tragedy—the success was too sudden and too much for the promoter manage-

ment which had kept enough promotion stock paid for by formulas and services, to retain voting control. Reports of earnings were suppressed, salaries of president and managers were greatly increased. Dividends were cut down. The dentist stockholders, observing fast increasing outward signs of prosperity by way of apparent increased distribution and national advertising, became suspicious. As their suspicions became confirmed, word spread among them, "Well, we're done again." Recommendations of the goods ceased on their part. Eventually a representative stockholders' suit in equity corrected some of the injuries, one of which was a sale to the company of a magnificent new factory on real estate previously purchased at a low price by the management and sold to the corporation at a vastly increased valuation. The company still operates, but the goose that laid the golden egg was killed. The magnificent opportunity based on the confidence and hopes of thousands of dentists was shattered.

Some of the things learned from this and other experiences emphasize the utmost importance of keeping the customer owner informed of the company's affairs. There should be a full realization that nearly every act of management will be regarded with suspicion. Dividends, if possible, should be paid at frequent intervals. Customer stockholders should be canvassed regularly the same as other customers. They should be kept "sold" on the merits of their company's goods. Enthusiasm and real interest in their company should be cultivated by every conceivable means.

When a large enterprise faces the need of additional capital, banking support often not only threatens the expense of large commissions but also a degree of control in the management. Many businesses have suffered by too much bank management. Railroads afford an example. A banking house or banking concern, having the power to dictate policies, has

put many white-collared men in places better occupied by men who have worked up from the ranks and know how to "move" the freight and passengers. Direct resort of the corporation to customer ownership has been successful under these circumstances.

I do not know how much of the rehabilitation of the New York, New Haven & Hartford is due to these facts alone but it is clear that in 1913 dividends had been suspended on the common stock, and foreclosure was threatened. Edward J. Pearson, an experienced railroad executive, was made president. He induced the business men and bankers in New England, the industries that used the railroad, to subscribe to sufficient refunding bonds to prevent foreclosure on the properties. Twenty-five million dollars' worth of 6 per cent refunding bonds were thus privately sold by the railroad direct to investors. In 1928 the railroad is again paying dividends on its common stock. Apparently customer ownership served the New Haven and brought it back to its standing as one of the country's premier properties.

In its annual report in 1927 to the National Electric Light Association, the Customer Ownership Committee emphasized the following ten cardinal principles:

1. Sale of securities must be direct from company to customer or through an agency of the company.

2. Safety of the securities must be amply protected by property and earnings.

3. Minimum rate of dividends must be provided for in so far as honest judgment based on experience can foresee.

4. A reliable sales market must be maintained to provide shareholders at nominal expense an opportunity to dispose of their holdings when they desire.

5. A partial-payment plan enabling customers who can save a small monthly amount to participate and to encourage thrift.

6. The proprietary interest and responsibility of shareholders requires they be furnished regularly with information as to the company's affairs.

7. Authentic information and advice to shareholders will guard against loss of capital by them in hazardous and fraudulent dealings from various sources.

8. Avoid large individual accumulations of stock and increase the number of shareholders.

9. Employees must make certain that all representations are true.

10. Managements must realize that customer ownership multiplies their obligations to the public and intensifies the trust placed in them. There must be continued striving for higher efficiency, better service, reasonable rates, courtesy, and progressive public relations policies.

Chapter VI

EMPLOYEE AND MANAGEMENT OWNERSHIP

OWNERSHIP of stock by the employee in the industry which employs him is not a new movement, but it has received great impetus within the last five years. Its object is to make the employee better satisfied, to make him more efficient, and to solidify the identity of his interest with that of the corporation. In 1927 the Princeton University research referred to below, revealed the total of employees' holdings in stocks of their own companies as substantially more than $700,000,000. A compilation of the National Industrial Conference made just a little later showed more than 400 companies aiding their workers to invest nearly $800,000,000.

It was shown that with corporations that adopted some active plan of stock ownership, employees had acquired over 5 per cent in market value of the entire issue, that an average of 23.2 per cent of the employees had taken shares, and that the average subscription was $1,313. The Philadelphia Rapid Transit Company was the leader, showing 27.81 per cent of its common stock held or as prospective holdings of employees. Their investment was $13,349,000. Procter & Gamble reported 11.6 per cent of its stock held by employees; Swift & Company, 11.39 per cent; Eastman Kodak, 8.44 per cent; International Harvester Company, 7.16 per cent.

The New York *Herald Tribune* on January 2, 1927, referring to these figures, said:

> The rise of employee stock ownership is significant considered solely in terms of corporate practice. These instances, including the largest and most powerful corporations, reveal that in only a few years em-

ployees have acquired from 8 to 10 per cent of the stock. Experts contend this gain in ownership is laden with fundamental consequences for industry. A 10 per cent holding by outside stockholders may be ignored by the management; an equal holding by employees cannot, mainly because of the importance of employees' morale.

The concentration of workers' investments in these giant corporations is in marked contrast to the national aspect, for it is estimated that only a little more than 2 per cent of corporate stock is held by employees in the United States. The biggest corporations, all of them non-union, have drawn the biggest share of the workers' investment capital. It is noteworthy, too, that the railroads which have a long history of union relationship are low in employee stock ownership. The Pennsylvania system, in spite of an elaborate plan, shows less than 1 per cent of stock held by 19,500 employees, while the New York Central has but 1.64 per cent. Thirty years ago the Illinois Central Railroad began to sell stock to employees, yet at present the market value of stock is a little more than one-half of 1 per cent of the total stock outstanding.

Labor union opposition is outspoken. It is feared by many that in periods of financial depression losses in income return and in market value of shares held will create more discontent than all the good that can possibly be accomplished in times of corporate prosperity. Many companies, while providing means for acquisition of stock, caution their employees that savings accounts, life insurance, and ownership of their own homes are more important, and that all stock ownership is a more or less risky financial adventure.

Of course the amount which the ordinary employee can lay by under stock ownership plans cannot be large. The article just referred to, however, names some interesting examples. Procter & Gamble, manufacturers of Ivory soap, have a plan particularly devised to meet the needs of the smaller wage earners. Five per cent of annual wage is deducted for stock purchase; his dividends come due on his first share of stock; they are credited to his account. The employee's first $1,000 worth of stock costs him only $300 cash. Some of these employees are now getting more income

from dividends than from wages. Louis Shutte, a blacksmith, out of his earnings has saved enough to purchase 600 shares. From these he draws an income of $3,000 a year. Charlie Bateman started at $15 a week firing boilers. Now he gets $32. But out of his wages he has saved enough to buy 550 shares of stock and a $15,000 home. One rather gasps at such accomplishments, but on reflection must realize that these are exceptional persons—the combination of thrift and good fortune which would do wonders for their possessors at any time and any place.

Reading on the subject compels me to believe that experience so far indicates on the whole that stock investment for the small wage earner should be approached carefully. It is highly advisable not to "oversell" this class of employee. On the other hand there appears to be nothing but enthusiasm for the idea when applied to the higher priced help—so-called management participation. Here there are helpful factors of larger amounts, a more direct feeling of relation of each person's own work to the results obtained, and the ability to assume the risk of loss without undue hardship.

Some companies have two separate plans in effect—one for the small wage earner and another for the larger or manager group.

The Dennison Manufacturing Company is one of several corporations which have been turned over by the original owners entirely to employees. There are two classes, "principal employees" and "employee industrial partners." The first class holds all the voting stock.

Representation in management by employee stock is thus far unusual. Massachusetts provides by statute for election of a director by employees, irrespective of stock ownership, each employee having one vote. Procter & Gamble employees have a representative on the board of directors. The

Stetson Shoe Company is said to have made similar provision.

Usually, where there is a special issue of employee stock, it is deprived of voting power. Elaborate provisions are made in the case of close corporations under which the stock must be sold on leaving the employment, etc. Two examples of charter provisions relating to employee stock are given below:

EXAMPLE I

Fourth. The total authorized capital stock of this corporation is Two Hundred Thousand Dollars ($200,000), divided into two thousand (2,000) shares of the par value of One Hundred Dollars ($100) each.

Of said stock fifteen hundred (1500) shares shall be known and designated as Class A stock, and the balance, five hundred (500) shares shall be known and designated as Class B stock. Except as hereinafter provided with reference to the shares of Class B stock, the shares of Class A stock and the shares of Class B stock shall entitle the holders thereof to the same rights and privileges.

The shares of Class B stock shall be sold only to persons who are in the employ of the corporation or about to enter its employ, and to other persons who though not employees or prospective employees of the corporation may have business relations or business connections with the corporation, all as may be determined upon from time to time by the board of directors or in pursuance of a resolution duly adopted by said board. The determination by the board of directors as to the right of any person to buy any shares of Class B stock shall be conclusive and binding upon all of the stockholders of the corporation.

The shares of Class B stock of this corporation are to be issued, received, and held by each and every holder thereof, upon and subject to the following terms and conditions which shall be binding upon each and every holder of Class B stock of this corporation, namely:

1. The right to be a holder of Class B stock in this corporation shall be a right which is incident to and connected with and effective during and only for the time the said holder is in the employ of or connected with, or has business relations or business connections with this corporation and/or otherwise continues to possess the qualifications which existed at the time of the issuance of said stock. In the event that any

holder of said Class B stock shall (a) sever his employment with the corporation, or (b) leave the employment of the corporation, or (c) terminate his relations or connections with the corporation, or (d) otherwise become disqualified for the continued ownership of such stock, the corporation shall have the right to buy the stock held by such holder at the price hereinafter set forth, and such holder or his legal representative shall within fifteen (15) days after any such event or disqualification tender the stock held by such holder to the corporation and it shall upon tender to it by such shareholder or by his legal representative of such stock, duly endorsed and properly transferred, pay to such stockholder or his legal representatives the book value of such stock to be fixed as hereinafter provided.

2. In the event that any holder of said Class B stock shall (a) sever his employment with the corporation, or (b) leave the employment of the corporation, or (c) terminate his relations or connections with the corporation, or (d) otherwise become disqualified for the continued ownership of such stock, or a change shall occur in the status of the holder of such stock (which status originally entitled the said holder to the said stock as determined upon by the board of directors or pursuant to a resolution duly adopted by said board at or prior to the time of the issuance of said stock), either by resignation, disability, death, or by discharge, or such holder shall otherwise be disqualified in the opinion of the board of directors from holding any of said Class B stock, the right of any such person as a holder of said Class B stock to continued ownership thereof shall *ipso facto* immediately cease and no transfer of the Class B stock so held at the time shall thereafter be made except as hereinafter stated.

3. The shares of Class B stock of this corporation are to be held by each holder thereof upon condition that he will not sell, assign or transfer all or any part of such Class B shares without first in writing offering the same for sale to this corporation, and the corporation shall have the right to purchase the same provided it shall give notice in writing to the person offering the same for sale within fifteen (15) days after the receipt of such written offer, or if no such offer is made, then the corporation shall have the right to purchase such stock within fifteen (15) days after the corporation has notice of such attempted sale, assignment, or transfer. Such offer, notice, and acceptance may be given by depositing the same in the post office properly registered and addressed to the company or to such stockholder or his personal representative at his address as it appears upon the books of the corporation.

4. The price to be paid for the stock by the company in the happening of the event or things as prescribed in paragraph 3 hereof and also in the happening of any event or things as prescribed in paragraphs 1 and 2 hereof, shall be the book value of such stock as it appears on the books of the corporation at the date of the inventory of the assets of the corporation at or as of the time of the last preceding inventory date.

5. In case any dispute arises between the stockholder or his legal representative and the corporation as to the book value of such stock as hereinbefore provided, then such book value shall be ascertained in accordance with the provisions of this Section Fourth by a committee of three; one to be appointed by the board of directors of the corporation; one by the person whose stock is the question of the sale or the dispute (or by his legal representative), and the third, a certified public accountant to be appointed by the two members appointed. The decisions of two members of such committee shall be conclusive and binding upon the corporation and the stockholder or his legal representative.

6. Compliance with the foregoing terms and conditions with regard to the issuance, holding, sale, assignment, or transfer of the shares of Class B stock shall be construed as a condition precedent to the continued ownership or transfer of such shares of Class B stock, and as a limitation upon the holders of Class B capital stock of the corporation, any future law of the state in anywise to the contrary notwithstanding.

The foregoing provisions shall be embodied in the by-laws of this corporation and every certificate of Class B stock shall have the same (or the substance thereof) printed on either its face or its back, and the acceptance of any certificate for Class B stock shall be considered as an agreement on the part of the holder of any of said provisions and as conditions precedent to the issuance and continued ownership of such certificate and of the stock represented thereby, and to the recognition by the corporation of any right, title, or interest in said stock on the part of such holder or of any person claiming to be the owner thereof or to be in any way entitled thereto.

Example II

There are also hereby created out of the total authorized capital stock Four Thousand (4,000) shares of the par value of One Hundred Dollars ($100) each, to be designated as "Class B" stock, which shall have no voting power and which shall not be transferable. This stock shall be sold and issued only to store managers and shall be designated on the

face thereof as "Managerial Stock," and shall be further designated by appropriate description of or for each store acquired; that is to say, if the first store acquired be in Los Angeles, California, the "Class B" stock relating to said store shall be designated "Class B" managerial stock, Los Angeles, California, Store No. 1, and if the next store shall be acquired in New York City, New York, it shall be designated as "Class B" managerial stock, New York City, New York, Store No. 2, and so on.

"Class B" stock shall participate only in dividends declared out of earnings and profits of the particular store designated on said stock certificates, and the holders of such "Class B" stock shall be entitled to no other or further dividend.

Out of the net earnings of each store there may be declared by the Board of Directors from time to time as dividends on the "Class B" stock, issued with respect to said store, such a proportion of the said net earnings as the par value of the "Class B" stock issued with respect to said store bears to the entire capital invested in said store.

The dividends of "Class B" stock declared by the Board of Directors shall be paid wholly or in part in either cash and/or "Class A" stock, in the discretion of the Board of Directors.

A store manager shall be permitted to purchase "Class B" stock, the par value of which shall not exceed one-third (1/3) of the initial capital of the store of which he is manager. The amount that may be so acquired by said store manager shall (within the above limit) be fixed by the Board of Directors.

The "Class B" stock held by any store manager who ceases, for any reason, to act as such store manager, or whose employment as such should come to an end for any reason whatsoever, shall thereupon immediately be delivered by the holder of such "Class B" stock, properly endorsed, to the corporation, and the Board of Directors shall thereupon in their discretion either (1) redeem said stock, or (2) convert said stock into "Class A" stock, as follows:

1. If the company shall in its discretion decide to exercise option (1), the holder of such "Class B" stock shall receive as payment in full for such "Class B" stock its book value, as shown by the books of the corporation. The option to purchase said "Class B" stock as aforesaid shall be exercised by the Board of Directors, and payment therefor made within six (6) months after the surrender and delivery of the certificate or certificates to the Board of Directors as aforesaid; the book value of said "Class B" stock, in the discretion of the Board of Directors, may

be determined by the said Board of Directors as of any date within and during the said six (6) months' period after the surrender and delivery of such certificate or certificates to the Board of Directors.

2. The corporation, if it does not exercise option (1), shall upon the proper transfer, surrender, and delivery of such "Class B" stock, issue to the holder thereof, within thirty (30) days after the expiration of the period of six (6) months provided for in the preceding paragraph, an amount of "Class A" stock equal at book value to the redemption value of said stock under option (1) so received as aforesaid.

Upon and after notice of intention by the corporation to exercise its option (1) to redeem said stock, or (2) to accept a surrender of said stock and issue in its place an equivalent in book value of "Class A" stock, all rights of the holder of such "Class B" stock to dividends or other rights or benefits on said stock shall immediately come to an end, except, however, as to those rights to which said stockholder is entitled by reason of the exercise by said corporation of said option (1) or option (2).

When and if any store manager who holds "Class B" stock, is no longer rendering service as such store manager for the corporation, the corporation shall at any time subsequent to ten (10) days after the sending by said corporation of notice by registered mail to the address of said store manager, as the same appears on the stock books or the records of said company, be authorized to cancel the said stock certificate or certificates so outstanding in the name of such manager, and in the discretion of the Board of Directors, to issue new certificates for the said stock to such other person or persons as the said Board of Directors may see fit.

In the event of such cancellation, the corporation undertakes to pay to said store manager (whose stock was so canceled) either the book value, if it exercises option (1), or issue in place thereof the equivalent amount of par value "Class A" stock, if it exercises option (2).

Upon the face of each and every certificate of stock to be issued to store managers shall appear the following: "This certificate and its sale, transfer, or other disposition, is subject to all of the terms and conditions with respect thereto, contained in the Articles of Incorporation of this corporation."

Elbert Hubbard, the author and publisher, was an early exponent of the employee-stockholder idea. Thus does he summarize his views and experience:

"The Roycrofters" is the legal name of our institution. It is a corporation and the shares are distributed among the workers. No shares are held by anyone but Roycrofters, and it is agreed that any worker who quits the Shop shall sell his shares back to the concern. This cooperative plan, it has been found, begets a high degree of personal diligence, a loyalty to the institution, a sentiment of fraternity and a feeling of permanency among the workers that is very beneficial to all concerned. Each worker, even the most humble, calls it "Our Shop," and feels that he is an integral and necessary part of the whole. Possibly there are a few who consider themselves more than necessary. Ali Baba, for instance, it is said, has referred to himself, at times, as the Whole Thing. And this is all right, too—I would never chide an excess of zeal: the pride of the worker in his worth and work is a thing to foster. It's the man who "doesn't give a damn" who is really troublesome. The artistic big-head is not half as bad as apathy.

The packing industry, the oil companies, and the steel companies have taken the lead in employee ownership. The Standard Oil Companies of New Jersey and California are reported in the New York *Times*, November 22, 1925, to have more than 25,000 of their employees on their stock books, while the steel corporation has 50,000, and the telephone company 65,000.

An important instance of employee ownership came at the close of 1928. It was the formation of the Graybar Management Corporation through which entire control of the Graybar Electric Company, one of the largest electric supply companies in the world, would pass to its employees. The management company has a capitalization of $9,000,000, divided into $6,000,000 preferred and $3,000,000 common. All the preferred stock went to the Western Electric Company, in payment for old Graybar stock. The common stock is sold to employees on the basis of length of service and rates of salary, and is paid for outright or in installments at the option of the employee.

Two excellent works are now available on the subject of corporate stock issued for the special benefit of employees,

Profit Sharing and Stock Ownership for Employees, by Gorton James and others; and *Employee Stock Ownership in the United States,* by Robert F. Foerster and Else H. Dietel. The first book describes, analyzes, and evaluates numerous profit-sharing and stock-ownership plans. Its recommendations are those of executives associated with the operation of these methods in their own companies. The second book is particularly useful because it summarizes the plans in use by a large number of companies, giving the names of the companies. It is written by the Director and an Assistant Director of the Industrial Relations Section, Department of Economics and Social Institutions, Princeton University. These discussions have to do for the most part with large corporations whose shares are either listed or available in "over the counter transactions." A somewhat recent literary contribution is *An American Business Adventure,* being a story of Henry A. Dix, who built up a large manufacturing business and turned it over to a group of employees.

Chapter VII

WHO IS THE AVERAGE STOCKHOLDER?

WHAT are the typical occupations of shareholders? An analysis made by the National Industrial Conference Board of the purchasers of fifty shares or more of an issue of 7 per cent preferred stock in a public utility showed distribution as to occupation of holder as follows:

Accountants	166	Janitors	119
Artists	81	Laborers	499
Bakers	153	Laundry workers	65
Bankers and brokers	65	Lawyers	77
Barbers	155	Machinists	499
Beauty culturists	52	Mail carriers	115
Bricklayers	65	Managers	496
Butchers	115	Manufacturers	153
Carpenters	483	Mechanics	530
Chauffeurs	601	Merchants	926
Clerks	2987	Messengers	91
Dentists	63	Metal workers	157
Doctors	146	Nurses	274
Domestics	623	Painters	182
Draftsmen	149	Plasterers	60
Dressmakers	372	Plumbers	257
Electricians	582	Policemen	347
Engineers	558	Printers	335
Factory workers	1058	Railroad men	312
Foremen	518	Seamen	51
Housekeepers	4029	Secretaries	314

The New York *World* says:

It will be observed that just as many bricklayers and just as many laundry workers bought this stock as bankers and brokers; and that the clerks and housekeepers outdistanced all other callings. Machinists were

more in evidence than lawyers, nearly seven to one, and for every manufacturer on the list, four chauffeurs invested their savings. And it must be borne in mind that this compilation took into account *only* purchasers of fifty shares or more, representing an investment of five thousand dollars, and that the stock is a representative, high grade issue, in which many small fortunes are invested. Less than two years ago two big electric companies sold stock to 3,856 purchasers. An analysis revealed the occupations of the nine largest groups of these new stockholders as follows: 3,347 housewives, 1,064 miners, 949 clerks, 401 salesmen, 336 school-teachers, 326 laborers, 250 stenographers, 237 farmers, 178 grocers and butchers. There are 7,088 shareholders in these nine groups—two-thirds of the stockholders on the list. One of the smallest groups was classified as "capitalists." There were only twenty-eight of them. The housewives outnumbered them more than one hundred to one. Here, gentlemen of the financial district, are your *real* investors.

Another canvass of the occupation of stockholders, conducted by a utilities corporation in the northwest, analyzed by B. C. Forbes and reprinted in the *Literary Digest,* disclosed holdings by loggers, ranchers, students, mechanics, telegraph operators, a game warden, a milk inspector, a carpenter, etc. The highest number of shares taken by any one buyer was twenty-five.

These surveys of occupation and amount of holdings indicate that almost any person today may be a stockholder. It illustrates the democracy of the investor class. It also suggests that every corporation having a wide distribution of securities should consider the advantage of making a similar examination of its stock list. Among other things, a study thereof should lead to methods and contents of reports more responsive to the understanding of its stockholders.

The woman stockholder should be given prominence in the classification for some companies, particularly corporations dealing in household products, food stuffs, and clothing, where such companies desire to develop the stockholder-customer idea. The magazine, *Good Housekeeping,* in a large display advertisement (January, 1929) says:

The woman of today is a *shareholder* in the well-managed industries that supply the wants of American life and the needs of her family. Today any director of any great company will tell you what a large shareholder she is. Also *Good Housekeeping's* Editor can show you thousands of letters from women with substantial means who ask advice about their investments.

What kind of person is your average, small, minority stockholder? Is he any different in his rôle as a stockholder from what he is in his rôle, for example, as a citizen, a political voter, or as an employer or employee, as a householder and taxpayer? He is. As a citizen and political voter he does not hesitate at all hours and in any place to voice sentiments of approval or disapproval. As a stockholder he usually keeps his mouth shut. As an employer or employee he makes known his discontent. As a householder and taxpayer he demands his money's worth. But as a stockholder your average person today is the most docile, the most shrinking, the most supine of mortals. The nonentity proprietor! What an anomaly! The ordinary human being lives in an atmosphere of joyful activity. But as a stockholder he is in a sort of coma.

Therefore, Mr. Corporate Steward, whoever you are—director, president, owner of control—you have a person to deal with who is suffering from an inferiority complex. To remove this complex is your first task. It will take more *action than words* to do it. Your stockholder is fed up on words. He must see action; he must observe for himself complete reversal of the old policy. His welcome to the family must be genuine.

Chapter VIII

THE CORPORATE STRUCTURE

THE corporate structure has great significance to the stockholder. If it is complicated, there will be interests from the start which will conflict with his own. Bond issues involve possibilities, by foreclosure, of entire loss of the corporate property. Preferred stock immediately suggests the deferring of common dividends; and, if cumulative, a long period in getting on a paying basis, a situation which nearly every new business must face, may result before long in such large arrears of unpaid dividends, as to make the common stock unmarketable.

Certainly it is to the interest of those who are desirous of encouraging the new era of the common stockholder, to strive to set up a simple corporate structure.

Of course, we use simplicity in the sense of the plain and direct. There is much to be said in favor of following the well-trodden path. Avoid the novel and untried in corporate structure. But follow the crowd intelligently. It is not necessary to add words upon words without limit in the documents that constitute the record of corporate existence and activity. Profuse expression may be a deterrent and not a help. It is incredible but true, that even our large and well-established corporate practitioners often copy the longest precedents they can find. No doubt such counsel seek to impress their clients with bulk as the standard by which the value of their services is to be measured. On the other hand the really learned, skilled, and conscientious members of the profession apologize for lengthy and complicated corporate legal documents.

Observe what Francis Linde Stetson, counsel for J. P. Morgan, the elder, has to say[1] about the modern corporate mortgage, which he himself had done so much to perfect:

> For a long time the managers of that corporation (the Erie Railroad) were the pioneers in the gradual expansion of the corporate mortgage from a simple real estate lien to the complex agreements which have become necessary to meet the increasingly exacting demands of the investing public. . . . The mortgages of the great reorganized railroad companies, such as the Southern, the Erie, the Northern Pacific, the Atchison, and the Union Pacific, made from 1894 to 1896, were the result of comprehensive study of such instruments by many counsel, and they established the form of the corporate mortgage now substantially followed. . . . The elaborations of the obligation are intended as inducements to purchasers. . . . Provisions for releases of mortgaged property require careful drafting in order to protect the bondholder and the trustee, and at the same time afford to the company reasonable freedom of action. Precedents may be found in the New York Central mortgage of 1913 and the Northern Pacific mortgage of 1914. It is such complexities of contract that enlarge some of the present-day corporate mortgages to volumes of two hundred printed pages.

The usual practice today in organizing corporations is somewhat as follows: As many forms are collected as conveniently can be gathered. The one on its face, appearing to be most like the one in hand is then largely copied. When counsel for the investment bankers who are going to handle the bonds come into consultation, some other form will undoubtedly be recommended by them. It may also develop that the trust company chosen to act as trustee under the mortgage will have a set of pet phrases exonerating them from all sorts of liabilities, "except wilful misconduct." These different angles will be adjusted—no doubt by concessions on the part of counsel for the corporation. Since no exact standard is set, it is natural to believe that the differences between

[1] Papers read in 1916 before the Association of the Bar of the City of New York, reprinted in *Some Legal Phases of Corporate Financing, Reorganization and Regulation.* The Macmillan Co.

the various mortgages sought to be largely copied, are merely verbal. There is often duplication because of failure to recognize the fact that two or more provisions are the same in reality, only couched in different words.

We are now in the midst of more extended certificates of incorporation (charters). Size and complications are growing in this document for two reasons: first and principally, because of provisions for preferred stock being enlarged, including vesting of power in preferred stockholders, to prevent sale of assets, etc., without consent of the holders of two-thirds of the preferred stock. The insertion of other provisions in the certificate of incorporation for the direct protection of the preferred stockholder, along the lines of clauses in corporate mortgages for the protection of bondholders is becoming quite the usual thing. Most significant of all are the long and complicated clauses incident to the new practice in Delaware and Maryland of issuing preferred stock in series.

On the other hand, nothing new appears in certificates of incorporation for the greater protection of the common stockholder. The only departure, so far as he is concerned, is the insertion of clauses negating his preemptive right; *i.e.*, right to subscribe to new issues before offer is made to the outside public; negating his power to prevent a sale of all the assets, etc.

The lengthy provisions for protection of the bondholder in corporate mortgages; the lengthy provisions for protection of preferred stockholders in charters; the absence of provisions for protection of common stockholders anywhere in corporate documents, naturally raises the inquiry, "Why so?"

The answer seems to be this: To a large extent the real money in the first instance is secured through the sale of the preferred stock and/or bonds through a banking house, which directs its best attention and the attention of its counsel toward the securing of every possible provision which

will protect the "investor," who it is anticipated will look to the banker or broker, in case of threatened loss, to take every possible step to prevent the disaster. The common stock at the time of flotation of the securities as a whole is in the hands of those in voting control of the corporation. These persons are content to rely on the great power which control gives, and are not concerned with charter or any other kind of specific provisions for the protection of the common stockholder.

If financing were more frequently accomplished through sale alone of common stock in corporations whose structures provided only for such issue, attention of bankers would be directed to protection of but one class of security holder. It is the present-day fashion to accomplish this by taking banking control, or at least by the bankers taking a substantial representation in a voting trust. I suggest that the time has come when it will be advantageous to all concerned to insert in certificates of incorporation positive provisions which will further protect the common stockholder.

For example, if the law of the state does not direct cumulative voting in the election of directors, but makes such provisions permissive (see citation of statutes in Appendix), the provision therefor should be inserted in the certificate of incorporation. Provisions for inspection of books should be positive, and not altogether negative. Provision in regard to preemptive rights should be as constructive as is consistent with the need of meeting conflicting court decisions. The example given in the Appendix leaves the matter entirely in the hands of the directors, but from this I see no escape in view of many court decisions giving preemptive rights, where the stock involved has long been authorized and available upon application by any one but no effort had been made for sale, or even giving such right where stock is to be used in part at least to acquire property, etc.

If preemptive right had been already confined to right to participate upon increase of authorized issue, then I would not favor waiving the right at all. Directors should be glad always to extend the right in such a case. The formality of offer can accompany the necessary statutory notice of the stockholders' meeting required by law to authorize an increase of this kind.

Simplicity of corporate structure seems advisable. The easily understood always inspires confidence. In fact many corporate promoters have obscured or have attempted to obscure a defective enterprise by elaborate corporate detail—long-worded certificates of incorporation—complicated by-laws—various high-sounding issues of prior preference preferred classes of stock, a, b and c stock, etc. Many times have I heard them quote from "The Mikado" that these things "add an air of verisimilitude to an otherwise bald and unconvincing argument." There is an old saying, "The less you are the more you must seem to be." Consequently it is to be expected that the unworthy will take on extensive corporate scenery.

How broad should be the purposes? Shakespeare seems to have reached the limit when he speaks of "a charter as broad as the wind to blow where it listeth," and the experience of many seems to prove an advantage in stating the purposes as broadly as possible. Frequently this can best be accomplished by omission of detail. But where detailed or specific purposes are set forth it is recommended that they follow the general purposes and are themselves preceded by the words "in connection with the foregoing, and not in limitation thereof," or some equivalent expression. This is in order to prevent possible application of the rule that the express mention of one thing excludes all others.

Breadth of purpose is not always desirable. The investor's capital may be attracted to a particularly conservative

kind of business or one in which the organizers by experience are deemed to be particularly qualified for success. For the corporate capital to be subjected to diversion, to more speculative risks, or to businesses in which the management has no experience, under broad charter powers will defeat the investor's intent. If such a prospective investor reads the broad charter powers or has them pointed out to him by a competitive stock salesman, he will probably cease to be interested. An apt illustration of this is the oil royalty business. When confined to its strict purpose of ownership of fractional diversified interests in numerous leaseholds in presently producing oil territory, it is one of the most conservative businesses imaginable. If the charter of such a company contains the usual broad powers used in the oil business generally, capital may, and no doubt frequently is, diverted to more speculative use, even to "wild catting." In such a case it is best to state the simple purpose of engaging in the ownership and sale of lessors' interests in oil leases or in part thereof, and nothing more.

A new, better corporation practice points to the advantage of giving more care to the statement of purposes. Precision will be rewarded by greater simplicity and its concomitants of faith and confidence.

The stockholder has a vital interest in the state of incorporation, since his rights and powers are so largely measured by them. Selecting the state in which incorporation is effectuated is a preliminary step depending in its decision upon several factors. The corporate structure or general scheme of corporate law is essentially the same throughout the United States. However, several states are more liberal than the rest in respect to the kinds and classification of capital stock, ease of amendment of certificate of incorporation, place of meeting of stockholders, holding stock in other corporations, permitting the creation of non-voting stock,

providing for voting trusts, dispensing with the preemptive right of shareholders to purchase new issues of stock upon increase or otherwise, allowing payment of dividends out of paid-in surplus.

These states are also favorable to the corporation and its shareholders, because of relatively low organization and annual franchise taxes and may specifically exempt shares of non-residents from inheritance taxation. To select that state and law best suited to the purposes and economy of an enterprise is not only wise and prudent, but a duty owed to the investors and to everybody else directly interested. Critics appear, now and then, who seemingly find it easy by innuendo and by direct statement to cast aspersions on this practice. They speak of states which "prostitute their sovereignty," "set up bargain counters for the sale of charters," "issue licenses to do anything anywhere, and by any means, so long as it is not done in the home state," etc. The highest courts of a number of the states supposed to have been imposed upon have had occasion to examine thoroughly this practice and have found nothing wrong about it, see Appendix, p. 250. There is always the answer that each state has the constitutional power to restrict the power of foreign corporations or even absolutely prohibit them from "doing business within its borders," and so far as "interstate commerce" is concerned Congress, under its powers of regulation, may practically do the same, should occasion arise.

The first state to enact a so-called liberal corporation law was New Jersey. To what extent large and varied interests throughout the United States took advantage of it is a matter of history. With that history came a great hue and cry against "trusts" and New Jersey as the home of "trusts." A commission, appointed for the purpose of examining the New Jersey corporation law, had found that the law was fair and honest, that the reasons incorporation had been secured

thereunder were principally the clearness of the law itself and its convenience. The courts had enforced its provisions and had prevented or given remedies against fraudulent and other wrongful conduct of promoters, officers, and directors; that the best assurance of proper use of the law was the expected continuance of this judicial attitude. However, for the governor, Woodrow Wilson, larger ambitions were appearing on the horizon. The "Seven Sisters" laws were passed, incorporation in New Jersey was no longer popular, some companies reorganized elsewhere, no longer could imputations be made against New Jersey as favoring the large corporate interests. It is interesting that Professor Ripley should have selected for a part of the contents of his book an address by President Wilson eloquently invoking recognition of personal liability in corporate affairs—a liability which New Jersey courts had been so ably working out and applying to increasing numbers of persons connected with corporations organized under its laws. But incorporation was diverted to other states, especially Delaware, which had copied the New Jersey law and impliedly the decisions of its courts, and now Delaware is adding its own decisions to the wealth of New Jersey precedents.

Selection of a state for incorporation is often influenced, if not determined, by the amount of organization tax and annual franchise taxes. In these days of large corporations, this item may be a matter of considerable importance. It seems fair to ask whether the tax in most states is not too large, rather than that some states are cheapening themselves only by low rates calculated to invite capital. A recognition of this may be noted in connection with the reorganization of the St. Paul railroad. It was contemplated that the new company, the "Chicago, Milwaukee, St. Paul & Pacific Railroad Company," would be organized in Delaware because of the heavy incorporating fees in Wisconsin. Wisconsin, how-

ever, passed a law (1927) reducing its fees, and the corporation was organized there, as had been its predecessor.

Delaware and Maryland are today the outstanding popular states. A little while ago Maryland was beginning to take the lead. Formerly the Delaware law providing for shares without par value allowed only common stock without par value, while the Maryland law allowed different classes of stock without par value. Maryland was the first state to allow the issuance of stock in series so that the directors could fix the terms of different issues by filing a certificate without the vote of stockholders. The Delaware law has been amended in these respects. Provisions regarding issuance of stock in series were put into the Delaware law in 1927. The Maryland law has complete provisions regarding the issuance of convertible securities not covered in the Delaware law. Attorneys sometimes prefer Maryland or Virginia because the Maryland and Virginia laws permit the issuance of par stock for less than par, but other states do not.

The initial tax on a large capitalization with par value was formerly less in Maryland than in Delaware but since the 1929 Delaware amendments, it is about the same in both states. However, the annual franchise tax is less in Delaware. The initial tax in Virginia, maximum $600, is less than in Delaware, but the annual franchise tax is much higher.

In case of a large capitalization without par value the initial tax is less in Delaware since the 1927 amendments. A much larger proportion of the Maryland corporations are companies having a large capitalization than is the case with respect to Delaware corporations.

For the purpose of the Maryland annual franchise tax, corporations having public or financial powers which are not to exercise such powers in the state of Maryland are classified as business corporations.

Delaware holding companies may obtain the benefit of

total exemption from personal property taxes on securities. This is done by depositing all the stocks, bonds, and other securities of the company with some trust company in Delaware. The company being incorporated in Delaware and all evidences of its personal property being within the state, no other state would have jurisdiction to assess a personal property tax. In Delaware there is no law taxing stocks and bonds in the hands of residents, whether individuals or corporations. Therefore, a holding company adopting this plan would be subject only to the annual franchise tax in Delaware, and the federal income tax. Trust companies in Wilmington act as trustees for many corporations in this respect, collecting the income and forwarding it, minus a small commission, to the parties in interest.

There is no inheritance tax on stock held by non-residents in either Maryland or Delaware corporations. Delaware seems to have made this advantage doubly secure, especially against any future legislative policy, by a Constitutional provision.

Those who favor corporate secrecy, a policy to which the author of this book by no means subscribes, will regard the following provisions of the Maryland law to be disadvantageous:

> The corporate books are open to the inspection of any stockholder or any stockholders holding in the aggregate 5 per cent of the outstanding stock, or 5 per cent of any class thereof, if two or more classes have been issued. A detailed account of the assets and liabilities must be made for inspection of stockholders within twenty days after written request by holders of 5 per cent of the outstanding stock, or 5 per cent of any class thereof, if two or more classes have been issued.

As before stated, New Jersey was formerly a popular incorporating state, but laws were passed known as the "Seven Sisters" acts, aimed against trusts and restricting the rights of corporations to hold stocks in other corporations. Subsequently the teeth were taken out of these laws, the various

restrictions being modified and eliminated. A former large inheritance tax on stock of New Jersey corporations owned by non-resident decedents has been taken off the statutes. The New Jersey law as a whole and many court decisions are regarded as constructive and helpful to legitimate enterprise, with the possible exception of certain decisions on reorganizations. The principal disadvantage in New Jersey now is a high annual franchise tax. This is the greatest obstacle to any measure of popularity by New Jersey.

Maine was formerly a popular state. The organization and annual taxes were low. Attorneys became familiar with its laws and used that state although the procedure for incorporation was cumbersome. They often chose Maine without any good reason. Then the organization taxes and the annual taxes were increased, and, although the increase did not amount to much, it turned attention to other favorable states. Maine has an inheritance tax on shares of stock held by non-residents; although it is possible to secure waivers of this tax, the requirements in that connection are troublesome. A reciprocal exemption to the inheritance tax was added in 1927.

Arizona was formerly popular on account of its being cheaper than any other state. It was much employed for "fly-by-night" schemes. There still is no organization tax and no annual franchise tax. The filing and recording fees are about $35. The annual registration fee is only $15. However, the charter must be advertised six times in a newspaper and this is expensive and troublesome. It is necessary to get the approval of the Corporation Commission before issuing securities. The law was enacted when Arizona was a territory and has not been modernized. Corporate existence is limited to twenty-five years. The corporate books are open to inspection by all stockholders without restriction. There are no statutory provisions or formal mat-

ters which should be regulated by statute (*i.e.*, classification, par value, issuance of stock for property, quorum at stockholders' meetings, etc.).

Nevada made a bid for favor in the Corporation Act which it passed in 1925. Florida passed a similar law in the same year, as also did Arkansas in 1927.

The Ohio corporation act of 1927 embodies a complete revision, notable because of the addition to the statutes in many places of the gist of court decisions. This law is being studied with a great deal of care. It is interesting to observe that the new Louisiana corporation act, effective January 1, 1929, is similar in many ways to the Ohio act, and it also embodies many provisions of the Uniform Business Corporation Act. It is possible that we have in these new laws a precedent and guide for more uniformity, at least on the part of states unambitious with respect to attracting incorporation therein by non-resident interests, content to provide sensibly for those at home, with an eye to keeping them there, if possible.

Before leaving the subject of selecting the state for incorporation, one important general factor should not be overlooked. Attorneys accustomed to one state having favorable laws are inclined to keep going to the same state; it becomes their custom; they become familiar with the laws of that state and when they are asked which state is preferable they recommend that state. Corporate officials likewise become familiar with the routine requirements of the statutes of some one state, and it is a convenience to them and indirectly an asset to the corporation for subsidiaries and allied corporations to be organized under the laws of the same state.

The selection of a suitable corporate name is becoming a more important factor in its relation to the stockholder—first, because of the greater importance of sufficient distinc-

tion to prevent the prospective investor from investing in one company when he is under an impression it is another.[2] We must remember that the average corporate stock buyer today is of an average type, unschooled in finance and depending upon general impressions and sometimes confused memory regarding business and affairs outside of his own immediate activities.

The name of the new corporation should describe or imply the principal activity, if possible, and should be as unlike that of competitors as conveniently possible. This task is the more difficult because the list of names of domestic and foreign corporations in the various states includes those of many defunct corporations.

Another reason for emphasizing the matter of corporate name in connection with the stockholder, is the importance, when possible, of connecting the product with the corporate name. This is of special interest where it is desired to cultivate the customer owner. For example, note, from this point of view the improvement in the name "Gold Dust Corporation," as compared with the former "N. K. Fairbanks Co."

Why not a better corporate name, anyway? The ones in general use are so hackneyed and so often inappropriate. No wonder it is difficult to secure a title not already registered with the Secretary of State by a domestic or foreign corporation, when so little imagination is used in submitting new ones. Think of all the corporations with the names American, United States, Federated, Interstate, etc. Secretary of State Francis M. Hugo, in an address to the New York State Bar Association, January 17, 1920, said:

[2] That the courts will consider this in deciding cases involving conflicting corporate titles, see British-American Tobacco, Ltd. v. British-American Cigar Stores Co., 211 Fed. 933 (C. C. A. 2d, 1914); Wall v. Rolls-Royce of America, Inc., 4 F. (2d) 333 (C. C. A. 3d, 1925); Hudson Motor Car Co. v. Hudson Tire Co., 21 F. (2d) 453 (Dist. Ct. N. J., 1927).

There are upward of 200,000 names on the index of corporations in the office of the secretary of state (New York), and this is a growing difficulty in finding an appropriate name for a new company, which is not the same as, or closely similar to one which has already been used. Fully fifty per cent of the names proposed from day to day for names of new corporations are found to conflict with names on the index. Without doubt a great many, possibly 50,000 or more of the corporations whose names are carried on the index, are inoperative and practically defunct. Yet they are, so far as the record shows, authorized to do business and must so be regarded.

"A good name is more to be desired than great riches," is an old saying, but nowadays, a good name, especially a good corporate name, is "great riches." The advertising value of certain titles must be conceded; thousands of dollars are expended on advertising which may be either brightened by a good corporate name or blighted by a poor one. A general sales manager for the Buick car told the writer that he considered the success of this branch of General Motors was all the more remarkable because it had been achieved with the handicap of a really disagreeable name.

Why not employ advertising talent in the beginning to originate a corporate title of real compelling force and interest? A short article in the *Saturday Evening Post* for May 28, 1928, though relating directly to trade names in general and to names of retail stores in particular, sheds light on the relative value of corporation titles. It relates the story of a young wife who wandered about the business section of a strange city and had lunch in a place called "The Blue Bird Inn." In telling her adventures to her husband that evening, she spoke of having had a good meal. Her husband asked her why she happened to pick out the place and she was unable to account for her choice. "Why, no one told me anything about it. I walked about and seeing the place, I went right in," his wife answered hesitatingly when pressed

for the reason. This apparently is supposed to illustrate the subconscious effect of an attractive name.

A survey showed that there was a prejudice against forced spellings, such as substituting the letter *k* for *c;* against common titles such as "Everybody's Market," and in favor of the unusual such as "Luxor," suggesting comfort and luxuriousness. According to the results of the questionnaire used, "Purity Market, Inc." would be a much more suggestive and inviting title than "Allebone and Company"; "Vogue Cleaners, Inc." would be preferable to "Manhattan Cleaning and Dyeing Company." "Mary Ann Chocolates, Inc." is much better than "Palace of Sweets Company"; "Photocraft Studio, Inc." would be chosen against "George's Photo Studio"; and "Wistaria Café, Inc." would be a much more popular name than "Harrison's."

A general practice in New York with respect to names of real estate holding or building corporations is well worth following elsewhere. It is now usual to use the address for the corporate name, thus: "Sixty-three West Fiftieth Street Corporation," or "One Twenty-five Prospect Park Terrace, Inc.," etc.

Similarity of name in the public utility field is beginning to cause concern. The words "power and light" or "light and power" have been used to death. The well established companies are particularly anxious to prevent the use of similar titles, because of investor confusion with respect to their securities. Some companies are making a practice of incorporating small domestic corporations in the important states just to protect the name.

Chapter IX

CAPITAL STRUCTURE; FINANCIAL SET-UP

THAT simplicity of capital structure is a vital concern to the stockholder appears from many sources. I am in receipt of a broker's circular recommending the purchase of Inland Steel Company stock and saying:

> As a result of the capital readjustment last spring, Inland Steel now has a simpler capital structure than any other steel company. The outstanding capital obligations have been confined exclusively to 1,200,000 shares of no par value. The entire $10,000,000 7 per cent Cumulative Preferred and $30,000,000 of 5½ per cent bonds were redeemed on April 1st, an issue of $30,000,000 4½ per cent bonds having been substituted for the older issue. This capital readjustment has resulted in a substantial saving in charges ahead of the common stock. Not only distinguished because of its simple capital structure, Inland Steel can rightfully boast of having a lighter capitalization, compared with capacity, than any of the other leading steel enterprises. Inland's bond interest figures out on 75 cents per ton capacity, whereas interest and preferred dividend requirements of United States Steel and Bethlehem Steel figure out at more than $2 a ton of their respective capacities.

The same circular recommends McKeesport Tin Plate Company, pointing out that its capitalization consists of 300,000 shares of no par value stock and that the company has no funded debt; also Miami Copper, stating: "Miami's outstanding capitalization consists of 745,116 shares of common stock with no funded debt."

For simplicity, behold the capital structure of the Standard Oil Company of California—15,000,000 shares common stock no par value, 12,594,098 shares outstanding. This and nothing more. No bonds, no notes, no preferred, no Class

A or Class B, etc. A corporation of world-wide scope—the largest crude-oil producer and the third largest refiner in the country. The balance sheet for 1927 showed a working capital of over $100,000,000.

The problem of appropriate capital structure where the idea or services of the organizer demand compensation to a substantial degree is interestingly met by the two private hospitals in New York City known as the Park West and the Park East. Dr. Harold Hays describes the place and structure of the first, namely the Park West, in *Hospital Management,* March 15, 1927, as follows:

> A properly organized company, along business lines, which is out to make a profit, is the only kind which will give the maximum of service in a private hospital. That may be a new departure in hospital building and management, but certainly conforms to the ideas of large, successful business corporations. In order to get money, it is necessary to show possible stockholders that they will no doubt get a substantial return on their money. So we organized two stock companies. The first was a realty company which would put up the building and equip it, and the second an operating company which would rent the building from the former company and would run the hospital. The first company had a capital of $250,000, 8 per cent, cumulative, preferred stock ($100 par), and 5,000 shares of common stock of no par value. Each subscriber to stock was given one share of preferred stock and one share of common stock in each company for each hundred dollars paid in. The other fifty per cent of the common stock was given to me for promoting the company, attending to the building and equipment of the hospital, etc. But an agreement was made to the effect that no dividends, other than those on the preferred stock, were to be declared until all the preferred stock had been retired at par. Meantime my life had been insured for two hundred thousand dollars so that, in the event of my death, there could be little possibility of loss.

The success of the plan is attested by the fact that it was duplicated on a larger scale in the subsequent promotion by Dr. Hays of the Park East.

For real estate and building financing offering more than ordinary protection to the stockholder, the "French Plan" [1] deserves attention. The Fred F. French Companies of New York City, developers of real estate, constructors and managers of large office buildings, apartments, and hotels, use these slogans in advertising to the investor: "The most preferred stock ever issued. Equal division of common stock."

The "companies" consist of the underwriter, "The Fred F. French Investing Company, Inc."; the architect and builder, the "Fred F. French Company"; the real estate manager, "Fred F. French Management Company, Inc.," and numerous real estate corporations which separately own various properties. The companies claim that in considering a new proposition they compile data as follows:

Land	Lowest possible price
Building, inclusive of labor, materials, architect, builder, underwriting, stock distribution, mortgage disbursements, legal and renting expenses, incidentals and a liberal amount for contingencies	Everything included
Total Cost—	
Finance:	
Mortgage	50% of land and building
Stock (capital invested)	50% of land and building
	100% of Total Cost
Income:	
Rent from apartments, offices, and stores	Gross Income

[1] A variation of this plan, known as the "Mandel," provides for ownership by the investor of shares in all the buildings and operations of the management company as well as preferred shares in a particular building.

Operating Expense:

Interest on mortgage.....
Amortization of mortgage.....
Taxes.....
Management—coal, help, etc.....
Allowance for possible vacancies.....
Dividends on preferred stock.....

Total..... Gross Expense

Net Profit:

Gross Income minus Gross Expense.

"Before we purchase a building plot we fill out the above schedule. If the net profits are one-tenth of the required stock (capital invested) or more, we accept the project as a profitable one—that is, one which will retire the capital within ten years. A separate owning corporation is formed with a number of 6 per cent cumulative $100 preferred shares the proceeds of which, together with the proceeds of the mortgage, will pay for land and building. Twice as many no par value shares are authorized as are preferred shares, so that there will be available one share of common to the investor for each share of $100 preferred purchased, and one share of common to be retained by the French Companies for their profit. No dividends are payable on the common until all the preferred is redeemed." The companies publish the following excerpts from their standard charter for an owning corporation:

The preferred stock shall entitle the holders thereof to receive dividends at the rate of six per centum (6%) per annum, and no more, cumulative from the date of original issue of each share separately and payable out of surplus at such periods as the Board of Directors may determine; and, in case of liquidation or dissolution of the company, the holders of the preferred stock shall be paid the par value of One Hundred Dollars ($100) for each share, with accumulated dividends, if any, less any and all amounts previously paid on account of redemption. . . .

After payment to the holders of preferred stock of the amount due at the time of liquidation or dissolution, the balance of the assets and funds of the company shall be distributed wholly among the holders of the common stock. . . .

No dividends or distribution of profits, whether in cash or otherwise, shall be paid or made to the common stockholders unless and until all the preferred stock issued and outstanding shall have been redeemed.

The latest development of the plan is to sell 6 per cent notes convertible into preferred and common stock. Thus interest may be paid at once and during the period of construction. The holder of the note may convert at any interest date within twelve months after issuance of certificate permitting occupancy of the building. After expiration of this option, the company has the option within two years next ensuing to convert or to redeem in cash, or to convert in part or redeem in part.

The "French Plan" has been gone into at some length, not only because it appears to afford a good structure for real estate operations, but because the ratio of preferred and common stock issued, its division, and provision for complete redemption of preferred before dividends or distribution can be paid on the common, are features which may well be adopted by many other kinds of enterprise.

Debentures with various features of profit sharing, used so much abroad, may be expected to gain favor in this country. The unsecured bond (debenture) with accompanying profit-sharing certificate, was introduced by Colonel Clarence Hodson, as the means of obtaining the constantly increasing capital required to finance the business of industrial loans. It seems to have served its purpose well. Comparatively few attorneys appear to be aware of the existence of judicial sanction for the issuance of profit-sharing certificates in any amount, without specific authority in the charter. This right, together with similar power in the directors to borrow money and issue notes (debentures) as evidence

thereof, establishes the foundation for capital expansion, without the cumbersome practice of charter amendment, and without disturbing control, or the relative vested rights of stockholders.

Increasing introduction into the United States of foreign securities will attract increasing attention to participating debentures. By way of example, there was recently announced, American Certificates for Participating Debentures of Kreuger Toll Company, a Swedish organizing and managing company, the largest stockholder in the Swedish Match Company. These participating debentures bear interest at the rate of 5 per cent per annum (payable annually) and are entitled to additional interest at the rate of 1 per cent for each 1 per cent by which dividends paid or declared on Ordinary Shares in any fiscal year exceeds 5 per cent.

An interesting example of debenture financing is the offering of Twenty-year 5½ per cent Debentures Series A (with detachable stock purchase warrants) of The Kendall Company, a Massachusetts corporation, one of the largest manufacturers and distributors of hospital supplies. The debentures are coupon in form, in denominations of $1000 and $500, and issued under a Trust Agreement restricting the mortgaging and pledging of the company's assets and the creation of funded indebtedness and providing a sinking fund.

Non-cumulative preferred stock confers such rights as are provided in the charter—*i.e.,* in the contract between the parties interested. It should be noted that these rights are greater than usually supposed. Is it not commonly supposed that a dividend once passed is gone forever? But if the promise is to pay dividends whenever earned, back dividends must be paid—that is to say, dividends earned in prior years but not then distributed.

Non-cumulative means when there are no earnings there

is no right then or thereafter in *respect to that year.* See article on "Non-Cumulative Preferred Stock" in *Columbia Law Review* for April, 1923.

Statistics regarding relative adoption of no par as compared to par shares was published in the *Conference Board Bulletin,* July 15, 1928. The report, among many other things, says:

> Although the device of no par stock was first authorized in 1912, by 1925 nearly five per cent of all the corporations in the United States had adopted such stock as a part of their capital structure, and the stock of these corporations had reached in value one-eighth of all the capital stock recorded.

Corporations which have issued common stock without par value operate in practically all the states. Of the total stock of corporations having no par value common stock, the largest share falls to manufacturing industries which are closely followed by the financial corporations in number though not in amount. Only three issues of no par value railroad stocks were found to be listed on the New York Stock Exchange. "The evidence presented is conclusive that no par value stock is making rapid headway, and business, at least large business, has shown itself ready to discard what has been designated as the 'fiction of par value.' "

Adoption of no par value shares is the common practice where stock is to be issued for considerations other than cash. Non-liability of the original holder, no matter what was paid in services or property, seemed to be the outstanding advantage. Now the better financial statement, and the means afforded to set up a surplus out of which dividends may be paid without violation of statutes of some states, are frequently the inducements.

It was to be expected that limitations to proper or expedient use of no par would appear. They are coming generally from what was anticipated would be a principal

advantage, namely, the right to issue these shares from time to time at different prices,[2] especially to meet the exigencies of a falling market. This is the very thing the prospective purchaser of no par value shares doesn't relish. He does not like the prospect that some one else may get the same shares cheaper—he does not like the prospect of dilution of his interest. The par value, on the other hand, holds up a mark below which he knows the corporation cannot legally dispose of its shares—at least, he feels there is something fixed—a pole star perhaps of ideality, but still something to steer by. The par value fixes boundaries—with the no par value share all bars are down. The buyer of par feels more secure in his bargain than does your purchaser of no par shares. Therefore, the successful combination offering of par value preferred, with bonus of no par value. Corporations having no or little water in their stock, with relatively small cost of financing, find it advantageous to issue par value shares—the sales resistance is less.

It is certainly an unlooked-for development of no par value that a reform conceived in the spirit of eliminating misrepresentation of value by retaining the dollar mark, should be accused of being an important accomplice in corporate fraud. But such is the case.

That there is in process a tendency toward common stocks would seem to further emphasize the importance of simple capital structures. As I am writing, there appears this statement from Clark, Dodge & Co.:

[2] But see Hodgman v. Atlantic Refining Co. (1926), 13 Fed. (2d) 781, U. S. Circuit Court of Appeals, reversing 300 Fed. 590 (District Delaware), holding that despite statutory authority in the board of directors to dispose of no par value shares for such consideration as they deem desirable, the price must be uniform for any certain period of time and the price must involve no substantial impairment of the rights of prior stockholders.

The common stock theory of profitable investment, evolved from the experiences of the past, has been so universally accepted, that investment interest has been drawn from the bond market and speculative interest from real estate and commodity markets to be concentrated in dealings on the Stock Exchange. The result has been the four-million-share days of today (as compared with the one-million-share days of four years ago) accompanied by the price excesses which have distinguished this market. *In the modern phrase* the American public has become *common stock conscious.*

With reversion to simple structures and larger use of common stock, there still remains a "hang over" of high sounding description from the heyday of fancy preferred stocks, debentures, and bonds. This morning's mail brought a circular announcing "Class A Prior Participating Common Shares"—whatever that may be.

It is so much the day of the common stock that offerings of preferred stock or bonds must usually be accompanied by common stock privileges, warrants, or convertible privileges. This is referred to by security salesmen as a "kick."

Should bond holders be given conversion rights, or rights to subscribe for stock at a fixed price? The Industrial Securities Committee of the Investment Bankers Association reported to the 1927 convention that the investors in bonds or debentures of industrial corporations having assets of less than $10,000,000 take a greater risk than do investors in obligations of larger corporations, and should receive in addition to their bonds "an option to participate in the future earnings of the company, either through conversion into common stock of the company, or through a warrant attached to the bond, giving the investor the right to buy common stock at a fixed price for a limited time, say ten years." Investment bankers do not all agree that this is essential. It is contended that more important than the size of the corporation is the character of the product manufactured—whether it is essential enough to insure prosperity of

the company during the life of the bond issue, and whether the company has a firm position in its own line. Some consider it better to give the buyer of a small issue added compensation in the form of a larger rate. When bonds of the soundest corporation sell on a 4¾ per cent basis, the smaller issues should yield 6 and 6¼ per cent. The compensation for taking the risk in the credit of a small company and for inferior marketability of the bond, in this way, is definite and begins to accrue from the time the bond is bought.

Cumulative preferred stock may likewise lead to results not contemplated in the ordinary business view. Note the Pennsylvania doctrine laid down in Sternbergh v. Brock (1909), 225 Pa. 279, 74, Atl. 166; to the effect that cumulative preferred shareholders of a going concern should participate in the accumulated surplus equally with the common shareholders after the common stockholders have been placed on an even footing with respect to past dividends. But see Stone v. United States Envelope Company (1920), 119 Me. 394, 111 Atl. 536, where the English and American authorities are reviewed and the general business view adopted, that in the absence of a contract to the contrary, the common stockholders take all the profits after the cumulative preferred stockholders receive the stipulated per cent dividends in full.

It is an important rule often overlooked, that in absence of limitation, the holders of preferred stock may be entitled to participate with the common. That is why the words "and no more" are frequently inserted after the preference rate.

The certificates of the preferred stock of the Hoffman, Dewitt & McDonough Company, a Pennsylvania corporation, provided that: "The holders of the preferred stock shall be entitled to receive when and as declared and the company shall be bound to pay a fixed yearly cumulative dividend of six per cent (6%) payable quarterly before

any dividend shall be set apart on the common stock." No dividends were paid on either the preferred or common stock until 1917, a period of nine years, when a dividend of 54 per cent, covering the current year and all arrearages, was declared and paid on the preferred stock and at the same time a dividend of equal amount was declared on its common stock. Proceedings to restrain this payment on the common stock on the ground that the holders of the common stock were not entitled to a dividend of more than 6 per cent without sharing the excess equally with the preferred, were sustained. The Pennsylvania Supreme Court said:

> The priority of the preferred stockholders rests upon the contract, and beyond the provisions of such contract they occupy no position toward the company different than that of the holders of common stock. When a dividend is declared, the former are entitled to first claim to the extent of their preference for the current year, and if there remains a sum more than sufficient to pay a similar dividend on the common stock, both classes of stockholders are entitled to share equally in the excess. In absence of agreement, express or implied, that dividends shall be cumulative, unpaid dividends in the past cannot be claimed. Likewise there is no logical reason for holding that common stockholders are entitled to go back of the current year, and claim to be reimbursed for unearned dividends in past years. To do so would render such dividends cumulative in effect without agreement. Accordingly, when during previous years no dividends were earned, this was conclusive as to the right of all stockholders, both preferred and common, except as to the contractural right of the former to payment out of future profits to the extent of their preference before the latter would be entitled to participate in the earnings. So far as the holders of the common stock were concerned their status was finally determined when during any current year, there were no profits to be divided. The profits so lost are lost forever, and each new year marks the beginning of a new dividend paying period.[3]

Considerable care is advisable with reference to the issuance of stock for properties and services. Court decisions

[3] Englander v. Osborne (1918), 260 Pa. 28, 104 Atl. 614.

have developed a certain technique of valuation, preferably by appraisal of disinterested experts. Care should be taken that the vote does not include that of any person who is to receive the stock. With the advent of the no par shares, the bars seem to have been let down entirely.. At least that is a general supposition, and no par shares are almost exclusively used in payment of intangible properties and of promotion services, and such issues are made, apparently without regard for Constitutional and statutory provisions still on the books, seemingly a relic of the pre no par value period, it is true, but with limitations applicable to no par value stock.

Take Delaware for example. Its Constitution Article IX, Section 3, reads: "No corporation shall issue stock, except for money paid, labor done or personal property or real estate or leases thereof actually acquired by such corporation." Section 4a of the Corporation Law provides that non par value shares may be issued for "such consideration as may be fixed from time to time by the board of directors." This is certainly subsidiary to the Constitutional provision. It would seem, for instance, that no par shares issued for a bonus (*i.e.,* no consideration whatever) are at least of questionable validity.[4] Surely they cannot be issued for services "to be rendered."

[4] New York holds that no par shares may not be given away as a bonus with preferred stock. Stone v. Young (1924), 210 N. Y. App. Div. 3030, 206 N. Y. Supp. 95.

Chapter X

VOTELESS STOCK

I BELIEVE the voteless stock, preferred or common, to be a mistake. It is, of course, a convenient way to cut down the amount of stock required for control. But other methods of control are, in my opinion, preferable from the point of view of the welfare of the corporation as a whole. (See Chapter XII.) The major consideration is that with the vote the shareholder gets a full, legally binding approval of the parties in interest. This is greatly to be desired from a practical point of view. It is like a trustee securing approval of his acts by the beneficiary. Experienced trustees constantly seek ratification, approval, acquittance, and release. That the voteless stock may not work out to the advantage of those in control appears to be demonstrated by the experience of Dillon, Read & Co. with Dodge Brothers, referred to in the Prologue of this book.

The voteless stock has come quietly and by degrees. As an adjunct to preferred stock it seemed harmless enough. Originally the vote was entirely by person, each entitled to one vote, irrespective of number of shares owned. It seemed more fair in the business corporations—the corporations for profit—that dollars be the unit, the more invested the larger the vote. State constitutions and statutes provided that stockholders should have one vote for each share held. By classification of stock and disparity in par values, the amount of vote could be separated from the ratio of investment. For example, each share of $100 par preferred would carry one vote, so also would each share of $1 par common. In such

a set-up, $100 would buy one hundred votes if invested in common, and only one vote if invested in preferred.

From small *relative* voting power of preferred it was an easy step to non-voting preferred. Arguments in court against it were largely based on the State Constitutions and statutory provisions just referred to, giving the stockholder one vote for each share held. This was met by the statement that it referred to stock which had a vote. That is to say, if the stockholder had a vote the unit must be one vote for each share. Such legislation, the courts said, did not imply that every stockholder must have voting rights. The voting rights was a matter for agreement between the shareholders, in which the state had no direct interest. In other words it was a waivable matter, in accordance with the distinctions discussed in Chapter II of this book.

Professor Ripley thinks that the disfranchisement of the preferred stockholder was comparatively easy, because his rights are thoroughly fixed in the preferred contract; and that there is a distinction here, when sought to be applied to the class of common stockholders whose rights, particularly to dividends, vest entirely in the discretion of a board of directors in whose election they have no voice. There undoubtedly is a difference, but I do not believe that those who are responsible for the non-voting common stock are conscious of any distinction in legal standing between such shares and non-voting preferred. The whole thing turns on vesting control where it can be had with little actual investment and on the argument that stockholders place little or no value on the right to vote.

The policing power of the mere right, the power, still vested though unexercised, seems for the moment to be overlooked. That the political voter stays away from the polls does not necessarily mean that he does not value his franchise. It generally means that the issues or the candidates

do not interest him—the choice presented so far as he can see is between Tweedle-Dee and Tweedle-Dum. The same situation, no doubt, generally exists for the stockholder voter, yet each would be loath to surrender his *right* to vote. He wants the weapon even if he isn't forever flourishing or using it. It comforts him to have it.

It makes all the difference in the world with respect to legal rights and liabilities whether one has the power to protect himself through the choice of directors or the choice of means to amend or to advance the purposes of the corporation, or whether others are in a position to run his property willy-nilly and to thrust their management upon him, giving him "government without consent of the governed." The distinction has been clearly brought out by all courts, when they have considered the essential features of various "Massachusetts trusts." When such a trust provides for periodical election of trustees, and ultimate choice is thus vested in the beneficiaries, it has been held to be a corporation; but when uncontrolled discretion is vested in a board of trustees, self-perpetuating, without any choice or power whatsoever in the beneficiary, a true trust is said to exist. By the same token it seems clear that directors with respect to those whose property they are handling, without election by such owners, are in reality trustees.

It is too late now, with the non-voting preferred stock in such common use, to say that non-voting stock is a misnomer. But it would be convenient for purposes of clearer thinking and discussion to be able to regard the word "stock" as connoting the right to vote, and to speak of non-voting preferred "interests" or non-voting common "interests." But it is too late to do this; yet the courts are strong as a whole in emphasizing the stockholders' right to vote. They frequently refuse to appoint receivers, or to "interfere with the management," because of the stockholders' right to

choose their own directors. The whole basis of "preemptive right," *i.e.*, the right in present holders to buy new stock on increase of capital or upon a new offering of previously authorized shares, rests upon the right to preserve his present relative voting power. This is the "right preservative of rights," according to the United States Supreme Court.

The New York Stock Exchange is said to have taken a general attitude against, or at least to have frowned upon, or looked with disfavor upon non-voting stock after attention had been directed to the subject by Professor Ripley in 1926. The general attitude in banking circles was canvassed at that time and seems to have been about equally divided. According to newspaper report, those opposed to non-voting stock raised two main points. The first is what they called the danger of "back room" changes of control. They declared that if unfavorable conditions should develop, it would be a simple matter for the holders of the controlling stock to transfer ownership, whereas this would not be so likely if the controlling ownership had been built up through purchases of substantial amounts of common stock with large cash investment.

The other question related to responsibility. It was declared by some bankers that if it came to a question of liability, the few holders of the voting stock would be held fully accountable for the affairs of the corporation. Those in favor of non-voting stock said the question was largely academic, since small proportions of stock assured control and that stockholders could be persuaded to vote any way the management desired. In the case of large stock issues where the name and prestige of a banking house are pledged to the success of the undertaking and where the public buys on the strength of the issuing house's reputation, it is only natural that the bankers should assure control remaining in their hands to make certain the proper development of the

property. Many corporations are controlled through management shares and the practice has been in force in England for more than a century.

It has recently been claimed that disfranchised common stock was thereby depreciated in price. George P. Wright, president of the *Economic Digest,* is quoted [1] as saying:

> Take the case of an eastern power company of considerable prominence. Early this year it began to assume a commanding position in the market and there were large sales of its common stock and its so-called class "A" stock. This latter stock carries no voting privileges but it is entitled to $1 in dividends before the common stock receives anything, the two issues thereafter sharing alike.
>
> In the last two years full dividends have been earned with an ample margin and both stocks have improved their standing on the board. However, the common has risen from 35¼ to 60 while the Class "A" has come up only to 45 from a start at 33. In other words, a spread of 2¼ points has been increased to fifteen in favor of the stock that carries with it the right to a voice in the management of the company. Had shares of each sort been purchased at the same time last spring they would now show profits of 70 per cent and about 33 per cent respectively, with the larger earning in favor of the voting stock.

The voteless stock does not stand on as firm a legal foundation as might be expected. Its use by many prominent corporations would naturally induce a belief that it must be practically unassailable. And we have some strong decisions holding that the creation of non-voting preferred stock is properly a matter of contract between the stockholders and that voting is a right which may be waived.[2]

[1] New York *Times,* December 24, 1928.

[2] People ex rel Browne v. Koenig (1909), 133 N. Y. App. Div. 756, 118 N. Y. Supp. 136; State ex rel Frank et al v. Swanger (1905), 190 Mo. 561, 89 S. W. 872; General Investment Co. v. Bethlehem Steel Corp. (1917), N. J., 100 Atl. 347; Morrell v. Geo. Brooks & Sons Co. (1908) (Delaware), 164 Fed. 501; Miller v. Ratterman (1890), 47 Ohio St. 471, 24 N. E. 496; Savannah Co. v. Silverberg (1899), 108 Ga. 281; 33 S. E. 908; Inscho v. Mid-Continent Development Co. (1915), 94 Kansas 370,

It all seemed certain enough until there came a decision by the Illinois Supreme Court [3] holding that the stock of an Illinois corporation may not be deprived of the right to vote, because of provisions in the State Constitution, making cumulative voting for directors compulsory.

Other states make compulsory provision for cumulative voting.[4] Deprivation of voting right though granted by the charter-granting state may be denied in foreign states [5] in which the corporation does business.

The conferring of voting power to a limited number of shares of common stock has brought forth objections which were not raised to the earlier application of a principle by depriving a relatively small number of preferred stockholders of voting power. It is admitted that the fixed rights of the preferred stockholder to amounts, time for payment and general obligation of payment of dividends, as well as return upon dissolution of a fixed amount of principal, places the preferred stockholder on a different basis than the common stockholder, who must considerably depend upon the personnel of his board of directors for income and for protection of his property. It is not at all certain that the question, if now presented to the courts upon a state of facts where a large amount of common stockholders, especially all those who have invested cash in the enterprise, are disfranchised, would be decided in the same manner as earlier decisions involving voteless preferred stock only. The determination of such a case is awaited with interest.

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146 Pac. 1014; St. Regis Candies, Inc. et al v. Hovas et al (1928), Tex., 3 S. W. (2d) 429.

[3] People ex rel Watseka Telephone Co. v. Emerson, Secretary of State (1922), 302 Ill. 300, 134 N. E. 707.

[4] See Appendix, p. 244.

[5] See Appendix, p. 244, *California*.

Chapter XI

INVITING THE INVESTOR; WELCOMING THE STOCKHOLDER

THE Company Law of Great Britain, by an amendment recently enacted, requires "a company having a share capital which does not issue a prospectus, or which has issued a prospectus but has not proceeded to allot any of the shares offerred to the public for subscription shall not allot any of its shares or debentures unless at least seven days before the first allotment of either shares or debentures there has been filed with the registrar of companies a statement in lieu of prospectus signed by every person who is named therein as a director or a proposed director of the company or by his agent authorized in writing in a form, the particulars set out in Part I of the First Schedule of this Act." This schedule is reproduced in the Appendix. I suggest that its form and contents exactly as here shown, or just as nearly so as circumstances will permit, be used as forming the larger part of offering circulars in this country. I am fully aware that many will be loath to disclose some of this information, especially as to how the promoter is compensated, and the interest of directors, etc., but I believe that it is just this kind of information, now usually hidden, which, frankly disclosed, will remove doubts from a more intelligent investing public, now often oversuspicious.

The law requiring honest representation is no more clearly stated than by Bispham's Equity (Section 208):

> The rules in regard to fairness in representations are to be particularly observed in prospectuses of projected companies. The utmost candor and honesty ought to characterize such public statements. Those who

issue a prospectus holding out to the public the great advantages which will accrue to persons who will enter into a proposed undertaking, and inviting them to take shares upon the faith of the representations therein contained, are bound to state everything with strict and scrupulous accuracy, and not only to abstain from stating as a fact that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature or extent, or quality of the privileges and advantages which the prospectus holds out as an inducement to take shares.

What offering circulars should contain: Voting power should be clearly set forth. Balance sheets should be of recent date.

In the case of preferred stock based upon a business housed in a building on leasehold property, the fact of the leasehold rental being a prior charge should be set forth in just the same manner in which an interest charge on bonds would be placed—[Report of Industrial Securities Committee to Investment Bankers Association.]

In the case of oil financing,

Issuing houses should see to it that their offering circulars reveal earnings after as well as before depletion and depreciation. They should also disclose whether intangible drilling costs, such as labor, etc., are charged against operating expenses or capitalized to be amortized over a more convenient later period. There should be no uncertainty left in the public mind as to which method is used so that there may be no opportunity for a dissatisfied purchaser of such securities to charge misrepresentation at a later date in the event of the issue declining marketwise.—[Report of Industrial Securities Committee to Investment Bankers Association.]

Bankers and brokers disclaimers of liability. There are several different ways of stating a certain "hedge" in offering circulars and advertising:

The above information is based upon official statements and statistics on which we have relied. We do not guarantee but believe it to be correct.

The statements contained in this advertisement, while not guaranteed, are obtained from sources which we believe to be reliable.

We have accepted as accurate the information and statements con-

tained in the above-mentioned letter and summary, but this offering is made upon the condition that no errors, omissions, or misstatements in said letter or summary shall give rise to any right or claim against us.

The information contained in this advertisement has been taken from sources believed to be reliable and, while not guaranteed, has been accepted by us in the purchase of these securities for our own account.

A committee reporting to the Investment Bankers Association says:

The impression given by most of the disclaimers is wholly negative and seems to attempt to shift all responsibility to the investor. The psychological effect is bad, for the purchaser naturally looks to his investment banker for confidence and conviction. Furthermore, we do not think that the dealer is fair to himself when he gives the public the impression that he wishes to disclaim all responsibility, for in the few instances that investment securities go wrong the banker invariably assumes responsibility in a conscientious effort to work out the difficulties. If, in the opinion of counsel, a non-guaranty clause is necessary to prevent malicious legal action, we believe that it would inspire greater confidence in the investor if it could be used in the affirmative rather than in the negative form.

The *Wall Street Journal* says that an investment house knows, or ought to know, that what it offers is genuine, and that before assisting a corporation to obtain new capital, or a new corporation to begin business, thorough scrutiny has been made. The *Journal* also says:

Any reputable house does this, and, in a sense, the danger is more apparent than real. There is a danger and it seems to be avoidable. Would it not be better business to give the proposed and desired investor an affirmative assurance? No guarantee of the stock or bonds is required, but it should be the rule to guarantee the facts about them as stated at the time of offering.

I understand that the practice of using these exonerating statements had its origin because of the case cited [1] in which brokers were held liable in fraud. The prospectus contained

[1] Willets v. Poor, 141 N.Y. App. Div. 743, 126 N.Y., Supp. 926 (1910); 155 N.Y. App. Div. 312, 140 N.Y. Supp. 300 (1913).

an estimate that the cost of building a railroad would not exceed a certain sum per mile, and an estimate of engineers as to the amount of coal per acre owned by the railroad. When the prospectus was released to the complaining bondholder, it had been demonstrated that these estimates were incorrect. This case seems to me to emphasize the importance of dating all circulars. A perfectly innocent statement made at one time may be fraudulent at another date, when more is known about the corporation or the properties described.

The day should soon come when the extent of stockholders' rights will be greatly featured in offering circulars, and financial analysts and writers will make more prominent mention thereof. Some day we may have stockholder rights (s. r.) rated and abbreviated thus: S. R.—; S. R. 15%;S. R. 50%; S. R. 75%, etc.

Legal opinion is a necessary adjunct to an offering of public securities—*i.e.*, state, county, and municipal bonds. It is usually accepted by dealer and investor as adequate, and a necessary assurance that the bonds in question are binding and legal obligations. It means that the power to issue the bonds exists, that they are within every statutory and constitutional limitation of indebtedness, that every step required to be taken has been taken in due time, form, and manner, and that sufficient tax may be levied to provide funds with which to pay the bonds.

Edward H. Collins, in the New York *Herald Tribune,* says:

> It is distinctly to be questioned if any influence in the last half century has contributed more largely toward raising the obligations of American municipalities to their present remarkable credit position than has the bond attorney, who, as one authority has pointed out, "stands between the taxpayer and the investor, protecting each against the other and working in the interest of both for a still higher development of municipal bond law and bond practice."

It would be a distinct improvement, I believe, if opinions of corporate counsel be secured in behalf of the investor in securities of private corporations, after the manner of the public bond offering. The statement that a given firm has passed upon the legal phases on behalf of the bankers and "so and so" on behalf of the corporation is not as reassuring to the investor as would be an opinion addressed directly to the investor, covering points additional to mere legal regularity. The investor is supposed to investigate the corporate status, as disclosed in minutes, etc., before he commits himself. Once having come in, legally he is estopped from complaining. Now and then a cautious and well-advised investor will have his own attorney investigate a corporation on his behalf before making or increasing investments therein. Is this not evidence enough of the usefulness of such procedure? This opinion should be furnished as a matter of course, without expense to the investor. No reputable law firm, I am sure, would fail to respond in a satisfactory manner, searching into every detail having importance to the investor. Reputation and standing as a member of the bar will be assurance enough that opinion directed to and in behalf of the investor will be everything it purports to be, even if paid for by the corporation, or by banker or broker. Such opinions once initiated would become a standard practice, and should do more than anything else to improve conditions for the stockholder, just as they have for the municipal bond investor.

In order that the exact intent of this suggestion may more clearly be understood, the following tentative form has been prepared by the writer:

To Prospective Investors in the Securities of The Better Corporation:

The undersigned, a member of the Bar of the State of New York, has examined the following documents:

(1) Certified copy of the certificate of incorporation of The Better Corporation.

(2) This corporation's by-laws.

(3) Minutes of stockholders' meetings; minutes of directors' meetings; minutes of meetings of Executive Committee, represented by the secretary to be complete up to and including November 1, 1928.

(4) Contracts between the corporation and its officers relating to compensations; also agreements in which directors and officers have a personal interest as opposed to their interest as such directors and officers; also contracts between this corporation and other corporations in which such directors and officers have an interest, represented to me by the president of the corporation to be complete up to and including November 1, 1928.

I have examined the president and manager with relation to states other than the state of incorporation, in which the corporation is "doing business," including states in which licenses have been secured, as well as those in which the taking out of licenses to do business is being considered.

I am familiar with the statutes of the state of Delaware, pursuant to which The Better Corporation is organized, also with the statutes of the states in which it appears to me, according to the information furnished, that the corporation is "doing business" as a foreign corporation. I am also familiar with the reported decisions of these states pertinent to all matters relative to considerations upon which this opinion is based.

My conclusions are that all legal formalities have been properly complied with. I find that all of the stock of the corporation amounting to 5,000 shares without par value was issued to James Smith, president of the corporation, in payment for United States patent rights granted and applied for on a certain device known as an "Improvement in means for preventing the unexpected stopping of gasoline engines," known in the trade as "Smith's Anti-Staller." Mr. Smith turned back 2,450 of the shares issued to him to the treasury of the corporation; and one of these shares is now issued from the treasury as a bonus with each bond or debenture of $100, each issued by the corporation. Under the doctrine laid down in the leading case of —— stockholders will be estopped from ever objecting to the amount of stock issued to Mr. Smith, all of such stock having originally been issued to him. All holders, therefore, are subsequent holders of his stock and debarred by his consent and approval of the transaction.

I find that Mr. Smith's contract with the corporation, in addition to

providing for a salary of $1,000 per month, grants him an option to purchase any amount of stock up to and including 400 shares at $50 per share at any time, expiring November 1, 1930, and that the corporation binds itself to retain the necessary shares for this purpose in its treasury until said date.

I find that a certain contract for gears used in the manufacture of the anti-staller is with the New Gear Company of South Norwalk, Connecticut, and that one of the directors of The Better Corporation, namely Charles Jones, is also a director of the New Gear Company. The records show, however, that Mr. Jones's interest in the Gear Company was disclosed in corresponence between the two companies, and that the contract was adopted and ratified at a meeting of directors, by a majority vote, Mr. Jones not voting, there being present a majority of the Board, without counting Mr. Jones.

I find that by reason of the fact that the corporation keeps a stock of goods on hand in its Detroit office and makes delivery therefrom direct to automobile manufacturers in Michigan that the corporation is "doing business" in that state as a foreign corporation. Failure to take out a license exposes the corporation to possible losses. Steps are now being taken to secure the necessary license.

Faithfully yours,

Is the new stockholder welcome? Generally he is not; in fact he is made to feel almost like an intruder. Indifference, cold shoulder, or high hat—it all comes to the same thing. I had this feeling of disappointment—chagrin—of not being wanted, when I became a shareholder in a Wall Street trust company. I had been a depositor for many years and had constant occasion to observe the company's outward signs of prosperity and growth. I was proud of being a customer. How much more thrill would I get as a part owner in all this activity and business—grandeur—marble walls—Corinthian columns and brass rail! I received my certificate for shares, formal notices of meetings, and dividend checks, and that was all. Never a word of invitation to visit the offices, examine the operations of the company—never a word of human explanation of the company's hopes and plans. I no

more felt any real part in the enterprise than if I were a rank outsider.

Contrast this usual treatment with what can so easily be the case. Take, for example, the practice of a great department store, R. H. Macy & Co., whose new stockholder, shortly after his name is recorded, receives a large envelope containing an engraved card personally signed by an officer and reading thus:

To the General Manager of R. H. Macy & Co.:

This will introduce you to Mr. So-and-So, a stockholder of the Company, whom I have invited to inspect our organization, at the request of the president. It is his wish that you designate a member of your staff to escort the bearer to the significant places in our building, some of which are listed on the following page. This is done in order that stockholders may not only have the information which is their due, but also the confidence which we want them always to have in us.

The president of an automobile manufacturing company might write the new stockholder as follows, preferably on his personal letterhead:

Dear Sir:

It gives me great pleasure to note that you have become a stockholder in Modern Motors, Inc. I sincerely hope that it will be profitable as well as a source of pride and that you will continue the connection indefinitely.

Your cooperation in every way will be acceptable and appreciated. If you are not an owner of one or more of our cars, we suggest that you call at your earliest convenience at our nearest salesrooms and exhibit this letter to the manager in charge. He will be glad to extend every courtesy and concession, all of which is due you as a part owner in this enterprise.

When in Detroit, do not fail to telephone our office. It will be a pleasure to send one of our cars to your hotel, in charge of someone who will take you for a visit to the factories.

Very truly yours,

The following may contain suggestions of value to the chief executive of an amusement company:

Dear Sir:

Permit me to welcome you to the family of stockholders owning Amalgamated Amusements, Inc. I enclose a booklet descriptive of our various playhouses and also a list of our recently released moving pictures.

I trust you will not overlook any opportunity afforded to patronize your own business, and that you will recommend and advertise our productions to your friends and acquaintances whenever you deem them worthy.

I beg you to attend the annual meetings of stockholders whenever possible. You will receive timely notice. I look forward to greeting you personally in the near future.

Cordially yours,

To further illustrate the point, let the president of a chain food store company consider this as possible contents of a letter to the new stockholder:

Dear Sir:

As a new stockholder in the Neighborhood Chain Stores, you will be interested to learn, if you do not already know, that we have recently established a store at 364 North Street, near your address. I trust you will become a steady customer at this store and will find it worthy of recommendation to your friends and acquaintances.

Do not fail to send me any suggestions which may occur to you from time to time as to management, also as to the line of goods handled by us. As a customer in a different community you are almost certain to have ideas which will be helpful.

Trusting that you will give us the benefit of your full cooperation as a member of the corporation and part owner of the business, I am

Sincerely yours,

Some corporate executives are wise enough to welcome every possible opportunity to renew contact with stockholders. For example, the North American Company sends questionnaires to its stockholders, seeking their reaction to the company's policy of regular stock instead of cash dividends. These are sent in a routine manner, but the president replies personally to the stockholders who initiate correspondence in regard to it. A newspaper reports that this takes a great

deal of the president's time, *but he feels that it brings the stockholders into closer contact with the company.*

Keeping the stockholder's interest alive by personal contact of the chief executive on every possible opportunity is a policy pursued by some. The following is an instance:

November 28, 1928.

Dear Sir:

You are cordially invited to visit the exhibit of the De Bothezat Impeller Company at the Power Show (week of December 3rd, 1928). This will give you the opportunity to survey the products now manufactured and the progress made by the Company to which you have extended your confidence and support. The Company is at present entering into a phase of rapid and successful development. This is why its exhibit at the Power Show will be of special interest to you.

With our most cordial regards, we remain

Very sincerely yours,
DE BOTHEZAT IMPELLER CO., INC.
G. de Bothezat,
President.

Some executives even go so far as to write a personal letter when the stockholder sells his stock, expressing the hope that he will some day return to the fold:

President's Office
AMERICAN TELEPHONE AND TELEGRAPH COMPANY
195 Broadway
New York

November 23, 1928

Dear Mrs. Treadway:

It has recently come to our attention that the stock of this Company registered on our books in your name has been transferred and that your account as a stockholder has been closed.

We regret very much to lose you as one of our stockholders, and hope that in the near future your name may be on our list again.

When you are again contemplating investment and desire any information relative to the stock of this Company, you may call on the local Bell Telephone Commercial Office for such information, and it will be

pleased to render such assistance as may be possible. Or you may address the Bell Telephone Securities Company, 195 Broadway, New York, which was organized to advise intending investors and to facilitate their transactions in Bell Telephone securities.

Yours very truly,
Walter S. Gifford,
President.

Chapter XII

CORPORATION CONTROL

CONTROL of the corporation, especially in respect to the kind of persons in whom it is vested, is of utmost importance to the stockholder. In fact, the well-informed stock investor today relies for the most part upon this factor more than any other. Ordinarily he assumes that the person or persons in control have a large personal financial investment in the enterprise, and that in looking after their own property in the skilled manner which a large property demands, they necessarily protect and advance the interest of the small investor.

There is a great deal in common experience to support the correctness of this point of view. A friend of mine put it this way:

> These articles in the *Atlantic Monthly,* referring to what was afterward published in book form as *Main Street and Wall Street,* by William Z. Ripley, made me feel at first that no investment in stocks was safe. But on further reflection I realized that I really depended on the persons that controlled the companies in which I have put my money, and that they could not harm me without hurting themselves a whole lot worse. And, besides, these people in control, having a great deal at stake, devote a great deal of their valuable time to the business, and I don't do anything but put in my money and expect to get back more in due season. As long as the people in control are persons in whom I can have confidence I am not going to worry any more about the safety of my investments.

Complain as you will about the factor of "control," and most people do it one time or another, it is certainly better to have control vested in strong hands and to know where it is vested, than to have a vacillating corporate policy shifting from one to another, each denying responsibility.

To control a corporation means to exercise a directing, restraining, or governing influence over it. This frequently

requires ownership of over fifty per cent of the corporation's voting stock; but this is not always so. Sometimes those in control own a much smaller percentage, even twenty per cent or less, but in addition are able to secure proxies or influence the voting of other owners, so as to aggregate over fifty per cent of the voting power; or such persons may constitute the majority of the voting trustees in a voting trust under which over fifty per cent of the voting stock has been deposited; or those in control may control another corporation which owns over fifty per cent of the stock of the corporation being considered; or those in control may dominate a trust, in form such as a Massachusetts trust, or common law trust. Control may also exist in the hands of those who own or can dominate the voting of a less amount than over fifty per cent of the stock, where the majority is not required to be present to constitute a quorum, and where the stock is widely scattered and the stockholders are accustomed to staying away from meetings and also fail to send in proxies. Usually, however, when we speak of control, we have in mind the ownership or domination as to voting of over fifty per cent of the voting stock. When referring to holding company ownership, the company controlled is called a subsidiary. A subsidiary is defined in the new English Company Act amendments thus:

> Where the assets of a company consist in whole or in part of shares in another company (whether held directly or through a nominee and whether that other company is a company within the meaning of the principle or not) and
>
> (i) the amount of the shares so held is more than fifty per cent of the issued share capital of that other company or is such as to entitle the company to more than fifty per cent of the voting power in that other company; or
>
> (ii) the company has power directly or indirectly to appoint or nominate the majority of the directors or persons occupying the position of director, by whatever name called in that other company, that other

company shall be deemed to be a subsidiary company within the meaning of this section.

Now let us briefly consider various instrumentalities of control. Just plain ownership of a majority of the stock is the one in use in most instances, no doubt, especially in corporations having a relatively small capitalization. Such means of control can scarcely be called an instrumentality. The solicited proxy is the next in extent of use. In order to prevent abuse of this form, nearly all, if not all states, limit the duration of a proxy, and also provide that it shall be at all times revocable. Proxy control seems to me to be mostly a matter of self-assertiveness or "nerve" on the part of those once in possession of office, with its reflection of prestige and also with the list of stockholders and their addresses closely at hand. One great advantage of proxy control to the corporation, as a whole, is the comparative ease of a determined opposition to gather strength to its cause through circularization and personal solicitation of an opposition ticket. It is just for the purpose of facilitating this purpose, or uniting the "outs," that statutes particularly provide access to the stock list, with right to copy same, on the part of the stockholder, the only limitations being those enacted in some states intended to protect against the obtaining of the list by dealers in lists, or brokers who use it "as prospects" for their own wares. Being vulnerable to opposition makes vested proxy control cautious and, I believe, on the whole, usually careful not to abuse its power. By the same token, proxy control is, of course, not an absolutely stable form of control. As a corporation prospers, those in control through proxies may well become anxious respecting competition that will loosen their hold on the reins, and they will be looking around for a more permanent or fixed form of control.

The holding company as an instrumentality of corporate control has the advantage of stability, but you must, of

course, control the holding company. This will require but a little more than half as much of an investment as to own over a majority of the controlled operating company, since you can control the holding company through ownership of a majority of its stock. If the holding company can be financed in part with bonds or debentures, or through the sale of a class of non-voting stock, the amount of investment needed for control will be reduced. At times one holding company after another is pyramided, each holding control of the other—those in command owning only a majority of the last company.

Keeping control by those "once in," through the holding company idea, without the investment of a single cent of their own money has been attempted in the following manner: The corporation to be thus controlled had a large surplus; it also had unlimited power to hold stock in other corporations. The directors caused an investment company to be organized and to be financed out of the corporate surplus of the parent company. The "investment company" then bought a controlling interest in the parent company. Thereby the directors in the principal corporation were able to dictate the vote cast by the investment company in the principal corporation, each company at all times controlling the other—absolute perpetuity in office without personal investment, and without the trouble of proxy getting. This arrangement has been held to be illegal.

I have no personal knowledge of this, but I am suspicious that the arrangement described is partially in effect in many corporations and unquestioned, partly because unknown. The ownership by the outside company is in most cases not complete and the outside company has less than control in the principal company, but the point is that a part of the surplus of the principal company is invested in a company, or companies, which in turn own stock in the principal com-

pany, and this stock is voted in favor of the "clique"—an intercorporate "log rolling" like the better known political "log rolling"—you help "roll my log" (vote my ticket in my corporation) and I will help you "roll your log" (vote your ticket in your corporation). The net result of this scheme or practice is to evade the law against any vote being cast with respect to stock which a corporation purchases in itself (out of surplus this is permitted) and holds in its treasury.

This law, of course, is intended to prevent a corporation from voting its treasury stock so as to enable those in a position to dictate the vote to perpetuate themselves in office. But by holding what would otherwise be treasury stock in another company, the voting power will continue. Easy enough if undiscovered; and easy enough when discovered unless dissolved by litigation, the success of which must be very uncertain, especially when the complainant is unable to prove not only all the essential facts, but also a fraudulent intent. There is nothing in perpetuating oneself in office that in itself is fraudulent or illegal.

So much for surreptitious or more or less concealed or perhaps sometimes sinister methods of control. Two openly declared methods are yet to be considered, the voting trust and the "Massachusetts" or "business trust."

The voting trust is a method frankly stated on the face of the agreement under which it is created, to be for the express purpose of controlling the policy and management of the corporation, by vesting in the voting trustees sufficient stock to enable them to elect a majority of the board of directors for the period of the duration of the trust. It was first erected out of the legal imagination of some lawyer or lawyers, unauthorized by express statute. It was first condemned as a bold attempt to evade statutes providing for limitation of the duration of proxies, also against the spirit of law seemingly directing an annual election of directors by the real persons in interest. Voting trusts continued to be formed

and were legally upheld in several instances where the purposes were said to be for the interest of the corporation as a whole, and all the stockholders were permitted to come into the trust.

An interesting review of the change of opinion developed in recent years by the courts and legal writers on the necessity, wisdom, and legality of voting trusts is contained in the case cited.[1]

Is it not a fair fundamental premise to take that *that form of control is best* which will produce the best results for the corporation as a whole? Everything considered, is it not to be expected that those having the most at stake will be most apt to exercise a control in that manner? That being the case, it would seem to follow that control is best vested in those who have invested the most money in an enterprise. If the stock of a corporation represents its entire capital and all of it has been issued for money at the same price per share, then the owners of a majority of its stock, having the most money invested, might fairly be supposed to be entitled to control its policies. Such a doctrine seems fair. It is convenient. It is beyond dispute that some rule must be adopted. Unanimous consent or any rule requiring more than a majority gives a negative control or power to block action to the minority, and minority rule we have agreed is unfair.

The foregoing result may have been obtained in the beginning when the theory of corporate structures and of the business corporation was started. But in practice a far different situation is brought about. In the first place great practical value is placed upon control. Although this control is theoretically exercised for the benefit of all, actually

[1] Mackin et al v. Nicollet Hotel Inc. et al (1928), 25 Fed. (2d) 783, sustaining a voting trust of stock in a Delaware corporation "doing business" in Minnesota.

the persons having it take on to themselves great benefits to the exclusion of others, placing themselves in such salaried positions as they choose, fixing salaries and bonuses at amounts of their own selection and often just as large as the traffic will bear, dictating contracts favorable to themselves or to other corporations in which they have interests—profiting in the purchase and sale of the corporation's stock by reason of intimate knowledge of the company's affairs or by knowledge of market manipulations of the company's shares, etc. All such advantages may not be secured or exercised in every company, and in some companies additional or other advantages may be available to the control.

Often control is decried by those who fear what control vested in others would mean to them or to the enterprise as a whole. They are not actuated by any desire of advantage to themselves, but believe they must have control to prevent others, in whom they have no confidence, from taking an undue advantage. An example of this is the inventor who fears that control may be acquired by large competitive interests, which will fail to develop his invention or will deliberately make its development unprofitable, or that those in control will "freeze" him out of his invention, by withholding or delaying development until his necessities compel him to sell out completely at great sacrifice. Many initial owners of other properties—mines, oil fields, timber tracts, small manufacturing plants—requiring large additional capital for development and obtainable only through incorporation, have the same fear.

At any rate, the control is considered to be so valuable that organizers of most corporations are loath to part with it. So much so that they will usually adopt any sort of scheme to keep the control in themselves or in a group of their friends—that is, any sort of scheme except the actual

investment of their own money to the extent of one-half or more of the required capital.

Usually this retention of control was accomplished by issuing a majority of stock to the organizers for properties previously acquired by them and turned over to the corporation, or for services rendered to the corporation in its promotion. When the actual cash needed was large, this result could only be obtained by overvaluing the properties or services. Although the courts allowed a generous latitude in this regard, the practice was regarded as "dangerous," inasmuch as it involved possible liability with respect to this watered stock as unpaid or partially unpaid.

But be that as it may, *control,* it will be noted, is not only in those who do not have the most money invested, but the fractional interest of the real investors is greatly diluted or diminished below that to which their cash contribution would naturally entitle them. Such a corporation's financial statement will show a large stock liability against a relatively small amount of cash invested. This handicap was reduced when preferred stock without voting power came into use. Less stock of such a corporation was required to keep control. Then no par value stock came. This kind of stock, issuable for any consideration without the necessity of valuation and with no individual liability against the holder even when issued as a bonus, enabled a corporation to make a still better financial statement, with control issued to others than the contributors of most of the money. Then finally the climax came, with common shares having no voting power. With the voting power limited to a class or part only of the common stock issue, a few shares, relative to a total capitalization, would carry control.

Judge Rogers said:

> In proper cases courts protect minorities, even minorities of one, against the oppression of the majority of stockholders and of boards of

directors. It sometimes happens, however, that a minority institutes "strike" suits and seeks to oppress majorities and to involve the corporation itself in disaster for purposes of their own, and for reasons not always revealed. So there are cases in which courts are compelled to protect minorities against majorities and majorities against minorities.[2]

The holder of a majority of stock is an actual, though not a technical trustee, for the minority stockholders.[3]

We have no doubt that certain sentiments philanthropic and altruistic, creditable to Mr. Ford, had large influence in the policy to be pursued by the Ford Motor Company. . . . There should be no confusion (of which there is evidence) of the duties which Mr. Ford conceives that he and the stockholders owe to the general public and the duties which, in law, he and his co-directors owe to protecting minority stockholders. A business corporation is organized and carried on primarily for the benefit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among the stockholders in order to devote them to other purposes.[4]

Vesting of control in a group or in another company may be deemed to be of such value to the controlled company, that it will so arrange its affairs as to seek to bring this about. As this is being written, an example of such anticipated beneficial control appears in the newspapers with respect to the Flintkote Company and Royal Dutch. The Flintkote Company, with headquarters at Boston, is engaged in the manufacture of asphalt shingles and roofing products, having plants in New Jersey, Illinois, Louisiana, and Ohio. The company notifies the stockholders that:

[2] Staats v. Biograph Co. (U. S. C. C. 2nd Cir. 1916), 236 Fed. 454.

[3] Alaska Juneau Gold Mining Co. v. Ebner Gold Mining Co., 239 Fed. 638 (1917).

[4] John F. Dodge & Horace E. Dodge v. Ford Motor Co., Mich., 170 N. W. 668 (1919).

Negotiations have been concluded with the Anglo-Saxon Petroleum Company, Ltd. (one of the group of companies commonly known in this country as the "Royal Dutch Shell" group), by which, subject to the approval of its counsel and of Flintkote, that company undertakes, after the redemption or conversion of all the convertible preferred stock has been effected, that it and/or one or more of such group will purchase from the company at approximately book value per share, additional shares which will constitute a majority interest in the common stock of your company. The association so to be formed your directors consider to be of great value to your company. It tends, in their judgment, to make available for development and expansion of your company's business the resources of the Royal Dutch Shell group which extend all over the world.

It will be observed control is here sought in a manner preknown to all, with the *consent of the minority.*

After all it is not "control" that is objectionable, but the abuse of control, like abuse of all other things in life, that makes the trouble. Autocratic authority in government is frequently said to be the best possible form of government, when benevolent and directed solely to the public welfare, and that it is only when it becomes selfish and self-seeking that such authority deserves the condemnation directed against it. In the same way autocratic corporate control, when directed solely toward the corporate welfare, may be found to be a good thing, however arbitrary, but we all feel safer when we know there are adequate checks and balances. Autocratic power to benefit is likewise power to destroy. In the long run and everything considered, we like our corporate control not to be too strong. Appearances of moderation will not satisfy; we must have the reality of reasonable moderation. The iron hand in a velvet glove may sometimes accomplish much, but we would rather have the human hand of the same softness and with no glove at all.

Cumulative voting is, in my opinion, an effectual remedy against the grossest forms, at least, of abuses of majority

control, since it gives the minority some representation on the board. Although this representation cannot affect positive action, it is a most powerful policing influence. The minority director's presence at meetings is a deterrent, and his absolute right to examine the corporate books is a valuable check.

The right of cumulative voting exists where a stockholder has a number of votes equal to the number of shares held by him multiplied by the number of directors to be chosen, and is allowed to cast or distribute them as he sees fit. I refer to this right as "permissive," where a state allows provision therefor to be inserted in the certificate of incorporation and by-laws of a corporation. It is "compulsory" when the state by constitution or by statute or by both provides for the absolute right of the stockholder to vote in this manner, without provision therefor in the corporate charter.

I have compiled and brought down to date citation of statutes and of constitutional provisions in the various states and this is printed in Appendix D. It is important to have before us the attitude of all the states. Unless the law is compulsory, not much good, in my opinion, is accomplished. Few corporations adopt authority to cumulate votes when the statute is merely "permissive." Application of a "compulsory" law to foreign corporations holding meetings within the state will probably grow in importance. The attitude of California in this regard is of interest. (See Appendix D.) Other states will probably adopt similar policies. Why not avoid all confusion and add another feature to attractiveness of your common stock, especially to the small investor, by voluntarily providing for cumulative voting?

Chapter XIII

DIRECTORS; MANAGEMENT

It is not possible to exaggerate the importance of good corporate management. There is nothing that so firmly illustrates the personal element in the actualities of success or failure as the kind of persons who run corporations. For a while we had a great many directorates where names were used for their supposed influence, and we have had a great many "dummies" as well as "dumbbells," but the new era of the small stockholder demands directors who direct, executives who execute, and managers who manage. Everything concentrates the investor's attention to the personalities of his *corporate stewards*—those in charge of his property—as he realizes his own lack of influence and power.

The following item appearing in the New York *Evening Sun* in December, 1928, is worth noting:

> It may have been a mere coincidence but when it was announced yesterday that Theodore F. Merseles had joined the board of directors of the Celanese Corporation the stock jumped 5½ points. The rise continued today. Mr. Merseles brought Montgomery Ward back into the sun and since his assumption a few months ago of the duties of chief executive of Johns-Manville that stock has risen more than 100 points. And some investment analysts put the factor of management about third or fourth in the lists of points to consider.

A moment's consideration of past experience will bring to mind how much success has been dependent upon outstanding personalities. It has been pointed out that history is but a succession of biographies—and the history of business and of corporations must be included as subject to the same influences as other branches of the records of events. It

is also easier and more convenient to think in the concrete rather than in the abstract. Human beings are handier to take hold of mentally than legal concepts, such as entities.

Is the majority rule by directors enough? It is undoubtedly wise to provide for legal action by a majority, in order that affairs of the company may not be held up by a stubborn or unreasoning minority. But is it not the part of wisdom in common practice to give heed to minority opinion? Error of inaction frequently may prove to be prudent in the long run. Such policy will certainly encourage the minority to take an active interest. Nothing could be more calculated to produce inactivity and silence than being perpetually overruled. Among prominent examples of success by unanimous action is that afforded by John D. Rockefeller. Edward T. Bedford, in *Collier's*, July 2, 1927, speaking of Mr. Rockefeller's business policies, says:

> He had a rule of doing nothing—at least nothing of importance—without the unanimous approval of his partners or associates. If they did not agree with him, he never became vexed or impatient. He would present the matter to them with infinite patience and good nature until he got their consent or concluded it was impossible to do so.
>
> One time he wanted to introduce an improvement which would cost about $3,000,000. He favored it, and so did all his directors save one. This one thought the enterprise unnecessary, a futile expenditure, and that it would actually prove a loss. *At meeting after meeting the matter was brought up and discussed, but the objecting member always held out.* Mr. Rockefeller might have gone ahead. But he preferred to have this man's consent, and so he just continued his efforts to win him over. Finally one day he said:
>
> "Now you think this improvement is unnecessary and may prove a loss. We think otherwise. All right, now I make this proposal: I will build this improvement out of my own funds and underwrite it for two years. At the end of that time if it is a success the company can reimburse me. If it is a failure, we will just forget all about it, and I will take the loss."
>
> That convinced the objecting partner. "If you can take the risk so can I," he said, and the improvement was adopted.

The great pipe-line enterprise appealed to Mr. Rockefeller's imagination and judgment, and he wanted to go ahead with it. It involved an expenditure of $50,000,000, which in those early days represented an audacious adventure in finance. One by one the partners were won over. A few, however, held out against it. But Mr. Rockefeller, though eager to start, waited for two years until he could see a *unanimous agreement in his board* to the plan.

Care should be taken that leadership of a corporation be vested in a person or persons who have the true cooperative spirit in their make-up. To get the most out of the corporate form of effort, everybody connected with it must coordinate his effort with every one else's effort. The slogan of "all for one and one for all" applies. This is impossible where the head is the type of individual who thinks he can properly do everything in the business, and that others are employed merely because there is too much for one (himself) to do—who habitually fails to give credit to others. Such egotists are unfortunately constantly found in the position of chairman, president, or manager, dominating the spirit of the entire institution to its great detriment. Stockholders, directors of the better corporations, must see to it that this type be eliminated.

Unfortunately men of outstanding organizing ability with the insight of selecting able lieutenants and of coordinating their work—of inspiring loyalty—the Carnegies, the Gerrys, the Sloans,[1] are too few. But there is always in a business men endowed by nature, if not by training, with the gift of inspiring others with the desire to work together and for one another and for the business as a whole. Such a person need not have as thorough a technical knowledge as others—he need not be brilliant; he must have good common sense;

[1] There are two Sloans that deserve to be included in this category: Alfred P. Sloan, Jr., of General Motors, and Matthew S. Sloan of the New York and of the Brooklyn Edison and other public utilities in and about New York City.

he must be able to discern ability in others; he must be modest. He should never put himself up as the "know all"; he must by his every act show that he himself is forever and always convinced of the truth that "two heads are better than one even if one is a blockhead," and that sometimes his is the blockhead.

No one can possibly foresee the full possibilities of corporate coordinated effort, under competent leadership. But note the conclusion in the Annual Report of the General Motors Corporation for the year ended December 31, 1926:

> In view of the fact that the year 1926 was the greatest in the history of the Corporation from every standpoint, and that the common stockholders have shared in this prosperity through dividends amounting to more than ever paid in any one year by any corporation on its common stock in the entire history of industrial enterprise, a few words as to certain factors contributing to that result, might not be out of order.
>
> The prosperity that General Motors has enjoyed, naturally, cannot be ascribed to any single influence, but on the contrary, has resulted from the combined efforts of many. It can be attributed mainly to increased effectiveness and efficiency within the institution itself. This means that the collective endeavor of each and every individual on the payrolls of General Motors, its subsidiaries and affiliated companies, in other words more intelligent work on the part of each and every workman as well as by those of the executive force, has been the dominating influence in the satisfactory progress of the Corporation.

An outstanding evidence of the real coordinated corporate spirit—only possible under leadership of the same kind—is found where every one in the company is true steel as a member of a family, each on an equality with the other except for such distinction as his character, industry, and devotion may earn.

Take, for example, the tribute "In Memoriam" of the Bankers Trust Company to Daniel Rinn:

> It is with deep regret that we announce the death of Daniel P. Rinn who came to the Bankers Trust Company twelve years ago as chief

special officer, following his retirement after thirty years' service with the New York Police Department.

By his kindliness, his courtesy, and his unfailing devotion to duty, he won the respect and friendship not only of his fellow workers within the organization, but also of hundreds of its customers. He brought to his task the sincerity and simple dignity which raised it to an importance greater than was indicated by its title or its many routine duties.

In his death we feel a profound sense of loss. We extend this tribute to his memory in recognition of his splendid character and in appreciation of his many years of loyal service.

What person, receiving a copy of the above printed in a manner and on paper befitting application to the company's highest executive, but did not feel, not merely regret for the passing of Mr. Rinn, but that the Bankers Trust Company itself, by this act of appreciation, elevated itself to a new level of esteem and respect?

An inspiring example of what the quality of loyalty alone will do for the success of a corporation is furnished by the experience of Daniel Willard, President of the Baltimore & Ohio Railroad Company. Within the memory of nearly every reader of this book that railroad shared honors with the Erie as the butt of comic weekly and stage jokes for inefficiency and generally bad service to the public. "I want to go to Chicago the worst way," said one member of a vaudeville team. "Take the B. & O.," was the answer of the other. Mr. Willard, by the sheer force of his personality and leadership, has brought about a complete reversal, so that the Baltimore & Ohio Railroad today deserves the compliment contained in the following answer of an employee to whom a question, relating to the reasons for the difference between the old days and the present, was directed by my friend and client, Mr. Hugh Lee Kirby. The employee said:

The Capitol and National Limited are the pride of Mr. Willard. Mr. Willard wishes us to do our utmost to make these trains a great success. He will not let us get too sanguine for fear we will overlook some detail

and fall down on the job. Yes, sir, I am satisfied with my job, because I am working for a man who knows his job and my job too. He came up from the ranks. We cannot fool him. He knows what to expect of us and we do what he expects us to do, because he is fair and just and so we work on this railroad with pride and enthusiasm just like one big family. We, however, compete for honors and try to excel in our work to carry out Mr. Willard's wishes.

"It is because of this universal spirit of cooperation," says Mr. Kirby, "that the soul of Daniel Willard permeates the atmosphere of the right of way of the entire Baltimore & Ohio system and it even seems to be in the machinery, because each engineer has one thought, and that thought is 'Mr. Willard wants this train to run on time without accident.'"

Large directorates are now avoided by the experienced. It is too difficult to secure a quorum. It is too difficult to get a large number really qualified to be directors in a particular business. Long lists of names have been used too often by the illegitimate get-rich-quick schemes. They are losing their convincing force to the majority of informed investors. Says the *Wall Street Journal:*

A long list of directors may look impressive to the recipient of the invitation to invest. But it would be profitable to consider what training the owner of the largest drug store in the adjacent city has received to make him capable of guiding the destinies of a new surety company, insurance organization, a so-called investment trust, or a financial holding company. The same thought might equally be applied to the other directors—perhaps an unknown senator, the head of a small construction company, the local manager of the electric light plant, or one of the owners of a decayed lumber yard. Conducting successfully a small local business is no warrant to assume capacity for directing the management of the funds of others and in an entirely different field. One of the most valuable maxims to the investor is the comprehension that a little learning is a dangerous thing. "Fools rush in where angels fear to tread."

The relation of directors and officers to stockholders generally has been drifting into "innocuous desuetude." After they secure his money, the corporation as a whole and through its management seems to lose all interest in the stockholder and the stockholder is likewise accused of losing interest in the corporation. The stockholder becomes apathetic—fails to attend meetings or to fill in and mail his proxy—even fails to exercise or to sell his right to participate in offerings of new securities upon increase or reorganization, suffering large direct financial loss. The typical corporation seems to say, "The stockholder is a nuisance," and the stockholder says, "Oh, what's the use?" How does it happen that the typical American stockholder takes the rumble seat in his own car without protest and seemingly without a murmur? This situation as a whole in my opinion is the most critical in our corporation situation today. Its correction offers the greatest opportunities for the improvement of corporation practice.

In this book we take up in detail various phases, such as customary failure of the corporation to welcome its new stockholder, failure to give him illuminating information, failure of the stockholder to attend meetings. The initial and greater fault is with the management. Management should, therefore, be the first to take steps to correct its faults and the correction of his own faults by the stockholder may follow. Also, a far-reaching, fundamental reason why we are where we are is that there is too much lawyer in the present situation. Management has its counsel always at its elbow paid for by the corporation and presumably ready to defend or to argue for the management at every turn. If Mr. Stockholder hires counsel it must be at his own expense. To ward off trouble, supposed or real, counsel for the corporation—*i.e.*, the management— prepares minutes and resolutions in advance, examines proposed reports. All the lan-

guage is law language. Then, too, the purely legalistic point of view is so destructive of initiative. How many times will the usual stockholder stand the wet blanket of the law? The policy of keeping the legal talent in the background, to be consulted in private after all that can be born of enthusiasm has been exhausted, deserves more extensive trial. Observe the success of the methods of the present New York Stock Transfer Association discussed in chapter XVII.

Indifference of stockholders is the excuse given by those who advocate cutting down the stockholders' legal rights, notably eliminating necessity of his consent upon sale or exchange of entire corporate assets—eliminating his preemptive rights upon increase of offered capital stock—extending the use of non-voting stock. The argument is: why should stockholders be vested with rights they do not care to exercise and by their failure to act hinder and delay the corporation? This is the lazy argument of the "easiest way." Obviously the faults should not be accentuated. The only cure is direct and cannot be avoided. The indifference of stockholders must be turned into readiness. To cultivate a new spirit of willingness—to get the stockholder on the job heart and soul —greater not less participating is indicated. Why attempt to palliate the trouble with greater weakness?

To have whole-souled participation by stockholders is certainly worth a great effort. Nobody yet knows what results will be obtainable by corporations one hundred per cent efficient in coordinated effort.

An uneconomical—too elaborate and expensive management—evils from which many corporations suffer, can be checked or held down by the criticism of an intelligent minority. This service alone is worth the new program of greater stockholders' participation advocated in this book.

Attempted exoneration of the corporate steward, director,

or officer, from liability to account with respect to private dealings with his company when the trend is and ought to be all in the other direction of more strict safeguard and protection, seems almost too absurd to be true. Professor Ripley calls it "getting out from under." Artemus Ward, the humorist, of old-time memory, gave a famous lecture on "The Mormons." On the first page of his program there appears this statement:

> Mr. Ward will not be responsible for any debts of his own contracting.

A certificate of incorporation contained this provision: "In the absence of actual fraud, no contract made or other action taken by the concurrent votes of a majority of the entire number of directors shall be invalid or voidable by reason of the fact that some or all of the directors are interested, nor shall any director be incapacitated from voting upon any such contract or with respect to any such action by reason of such interest." It was held that this clause "does not help out" a transaction by which incorporators or subscribers passed a resolution that in the opinion of the directors, rights secured by the promoters were worth $1,750,000 and that full paid, common stock be issued therefor. Said the court: "We need not discuss the effect of this clause in the articles of incorporation. It can have no such force as is claimed for here, and if it could affect such transactions as we are discussing it would clearly be against public policy and without force." [2] "Instead of exoneration any means of increasing the factor of integrity should be adopted," says John T. Flynn in the *Outlook and Independent* (February 20, 1929), after reviewing the controversy between Col. Stewart, Chairman of the Standard Oil Company of Indiana and

[2] Whalen v. Hudson Hotel Co., 183 N. Y. App. Div. 316, 170 N. Y. Supp. 855 (1918).

J. D. Rockefeller, Jr. "I believe that as the nation's business is increasingly controlled by large corporations which in turn are owned by the public, it is essential that the stockholders in these companies have absolute faith in the integrity of their officers and directors if the structure of our civilization is to endure."

Mismanagement is understood to be the cause of most failures. The study of banking brings out the experience that neglect of directors is a strong causative factor in bank failures. Is it not reasonable to suppose that the same reasoning is applicable to other forms of business? Joseph W. McIntosh, Controller of the Currency, addressing the Florida Bankers Association, said:

> Most failures involve mismanagement in some form. Directors cannot merely select officers of good reputation for ability and integrity and then leave the affairs of the bank in such officers' hands without any supervision or examination than mere inquiry of such officers if everything is going along satisfactorily. They must maintain a supervision of the bank's affairs, have a general knowledge of the character of the business and the manner in which it is conducted, and know on what security at least its large lines of credit are given.

"No bank is stronger than the character and abilities of its board of directors," advertises the Philadelphia National Bank. Is there any reason why the same maxim is not applicable to all other business? A prudent man entering into a partnership seeks an associate with experience, judgment, and financial strength, one with ability and willingness *to cooperate.* A stockholder entering a corporation has no choice as to who his fellow stockholders shall be. In the corporate scheme the board of directors takes the place of the managing power of each partner. The stockholder should look to the *director* to have the qualities which he would demand in a partner.

The great success of the Vacuum Oil Company is attrib-

uted to good management. Every director is an executive in charge of some department. "The directors," says the *Wall Street Journal,* "are on the job every day in the year. Over the last decade, Vacuum has made even its small shareholders rich."

It is a shameful thing to contemplate a protection to stockholders, slowly built up as the result of painful experience and laborious argument finally adopted by the courts, wiped out in a single night, so to speak, by a hasty, inexperienced, and politically saturated legislature. Take, for instance, the purchase of shares of a corporation by a director from a shareholder. The Michigan *Law Review* for May, 1921, says:

> In 1910 the weight of judicial decision had undoubtedly established the rule that a director in purchasing the shares of a non-official shareholder was bound by no duty to the shareholder to disclose any facts relative to the condition or future prospects of the corporation, even though those facts might have had an important bearing on the then present value of the stock. And if the sale was conducted without actual fraud on the part of the director, that is, without misrepresentation or active concealment, the sale could not be set aside, nor could the director be held to account to the shareholder from the profits resulting from a rise in the value of the stock immediately subsequent to the sale.

In 1909 there had come the United States Supreme Court decision in Strong v. Repide, wherein for the first time there appeared the *special* facts doctrine, that where there are special facts, the director must make a full and accurate disclosure of all facts within his knowledge, or be liable for the profit resulting from the transaction.

That attempted exoneration of directors is going in the wrong direction is apparent from English experience. Amendments to the "Company Law," recently adopted by the British Parliament, aim to prevent the practice of having dummy directors; enacts that if a company is proved to have been carried on for fraudulent purposes, every director

shall be personally liable, without any limitation. When a company is convicted of any offense, every director shall be deemed guilty of this offense unless he can prove that it took place without his knowledge and consent.

A just cause of complaint against typical management is the purely formal treatment of stockholders in the matter of notices of meetings and of rights.

Why such hurry and short notice? Complaint of lack of stockholders' interest, delay or failure to send in proxies, is often due to the short time allowed for action. As the last hour approaches alarm and apprehension spread. Longer notice would prevent this. But it is characteristic of American business to come to quick conclusions and to expect quick action—generally on the other fellow's part. As far as corporate officials and counsel are concerned, there is a marked tendency to wait until the "eleventh hour," or until the "last dog is hung." Contrast this practice with this news item:

> The Royal Dutch Company announces a proposal to issue $33,000,000 additional stock, but shareholders will not get an opportunity to subscribe until January of next year, nearly seven months hence. This delay, no doubt, looks strange to some American bankers who may announce a new stock or bond issue one day and the next day make a public offering. But the Hollander does things a little differently. The announcement of Royal Dutch is simply a notice to shareholders and others interested that they have six months or more in which to save their florins before the actual offering is made. It is a convincing illustration of Dutch thrift and foresight.

That the customary time of notice of meetings in this country (ten days) may be too short, might appear from English experience. The bill of amendment to "The Company Law," recently adopted by Parliament, compels a fourteen-day notice to be given of a shareholders' meeting at which a special resolution is to be passed.

Chapter XIV

ACCUMULATED PROFITS; SURPLUS; DIVIDENDS

THERE is no place in corporate practice where the stockholder so fully realizes the distinction between himself and the artificial creature he and his fellow stockholders constitute, as when he contemplates the earnings or the surplus available for dividends. It is such a far cry from the corporate treasury to his own pocket.

Like most problems this one has a threefold possible aspect: the two extremes—none or little profits at one end—enormous profits at the other end—just average condition in the middle. At the poverty end, comes the strain on directors to declare dividends to keep up the credit, to help sales of stock, in the face of statutes making them personally liable, to say nothing of criminal liability. No matter how liberal the charter-granting state, strict laws of a foreign state, like New York, for example, may apply. Surely "a little earning is a dangerous thing." At the rich end there is the melon patch, large corporate profits growing larger in the sunlight of prosperity. Around the patch is built the high board fence of secrecy. When will those luscious honeydews be ripe? When will the carving take place? Who knows? Only those on the "inside."

Problems relating to the legal disbursements out of surplus by way of dividends take on some new aspects, as we enter the new era of the small stockholder.

In the first place there is more pressure than ever to cause many new corporations to agree as far as possible to pay some form of return to the investor from the start. The stock salesman likes to have some form of security and an

argument for the many small investors, who must take their money from savings bank accounts. The loss of interest is the first thing they think of. Therefore the effort to legally pay a return from the start, although it will undoubtedly be years before the corporation can get on a paying basis and accumulate profits out of which dividend payments can be made. Payment of dividends out of principal has long been one of the blackest of corporate crimes. Such procedure smacks of fraud—payment of dividends always implies existence of a legal surplus out of which it can be made. Representation, directly or indirectly that such surplus exists when it does not, is plain misrepresentation of a material fact. How, then, shall it be done? A clean-cut, easily understood method is the corporate note subsequently convertible into stock. For example, see the French Plan described in Chapter IX. The investor starts in the creditor class, to which interest may legally be paid, until the corporation has a legal surplus out of which dividends can be legally paid, at which time the corporation compels conversion, forcing the investor out of the creditor into the stockholder class, but only at a time when dividends can legally replace interest.

Then there is the creation of a paid-in surplus, out of the proceeds of the sale of stock, or out of the proceeds of the sale of some class of stock—a procedure at least questioned as to its legality until expressly authorized by recent statutory amendments, notably in Maryland, Delaware, Ohio, and Louisiana. Pursuant to these statutes specific authority is inserted in the certificate of incorporation. Examples from charters recently filed in Delaware and Maryland are contained in Appendix B.

With provisions like the above in the charter, and backed by provisions in the statutes themselves, the directors place any amount received over par to surplus, and so much of the

proceeds of the sale of no par value shares as they see fit; and out of the surplus thus created, or enlarged from time to time, dividends are declared and paid.

Full effectiveness of such dividend payments may not as yet be conceded, because laws of foreign states may interfere. For example, New York provides in the penal law that dividends may only be paid from "earned surplus," and this law specifically applies to "foreign corporations doing business in the state."

The movement is in full swing, however, and many corporations are today taking advantage of new authorized authority to pay dividends out of paid-in surplus.

We mention this new practice because of its relation to the frank and open method of inviting the investor and keeping the stockholder of today supplied with easily understood information, advocated in this book. There is danger in the practice of payment out of paid-in surplus of misleading any interested person. Ordinarily we think of, take for granted, or subconsciously believe that *dividends mean earnings* and that the company that pays them has made or does make money. As making money is the acid test of every enterprise, no more important factor than dividend payment can be used to represent or to misrepresent the status of a corporation.

Under the new practice, the investing public must immediately be taught a new important lesson, namely: *Investigate the source of dividends; they may be paid from paid-in surplus, in which event not only are original resources being depleted, but take warning that such payment of dividends is no proof or indication whatsoever that the corporation is a profitable enterprise.* This should now be added to the questionnaire and warning practice described in Chapter XX.

A corporation capitalized in whole or in part by a patent,

which, of course, is constantly approaching the period of expiration, or by a lease, or by oil wells, standing timber, or a mine, are said to be engaged in the exploitation of wasting assets. It has long been understood that such a corporation in paying dividends must necessarily be depleting its capital, unless some replacement policy is kept in effect, usually in the form of purchasing new properties. Former doubts as to power of such corporations to pay dividends without considering the depletion factor have been removed in Delaware by amendment in 1897, as follows:

> Subject to any restrictions contained in its Certificate of Incorporation, the directors of any corporation engaged in the exploitation of wasting assets may determine the annual net profits derived from the exploitation of such wasting assets without taking into consideration the depletion of such assets resulting from lapse of time or from necessary consumption of such assets incidental to their exploitation.

Regular stock dividends is a policy adopted by the North American Company, a prominent public utility holding company. It is being watched as a valuable experiment. The common stockholder, instead of receiving a cash dividend each quarter, receives one-fortieth of a share of common stock for each share held, or 10 per cent in stock annually on his holdings. If he desires the cash, the stockholder sells the scrip representing the stock dividend. Frank L. Dame has been keeping in close touch with the desirability or non-desirability of this policy through a questionnaire accompanying correspondence with the stockholders. That it has been successful, Mr. Dame says, is shown by the increase in the number of stockholders from 3,000 in 1920 to more than 42,000 in 1928. By not distributing its cash earnings the company has been enabled to follow a regular policy of plant expansion and purchase of new properties. Increasing funded debts and preferred stock issues of subsidiaries remain balanced by the increased common stock of the parent

company, which, Mr. Dame says, helps the system to maintain a proper balance between the classes of securities.

The hoarding of profits on the part of certain corporations is an evil worthy of attention and correction, if possible, especially in the new era of the small stockholder. Amounts due such a holder can scarcely justify litigation on his part, and besides it is a generally understood rule that the courts will not interfere.[1] The few cases where judicial relief has been afforded seem by their very exception to *prove the rule,* in accordance with the time-honored adage,[2] and only grant relief when the board of directors have acted dishonestly or fraudulently in withholding distribution. A well-known law writer[3] believes that where it appears that dividends have erroneously and unfairly been detained from distribution to the stockholders for a long period of years, a point will be reached where a court of equity should unhesitatingly intervene and direct the directors to do their duty and declare a dividend.

How would it do for corporations, especially those asking support of large numbers of small stockholders, to insert in the certificates of incorporation or in their by-laws, or both, an additional clause regarding dividends, by which they would agree to disburse, say, not less than 60 per cent of applicable increase in dividends on common stock? This would leave 40 per cent for replacements and accumulation. The 60-per-cent figure is selected because it is now often mentioned as the practice of certain corporations. This figure, of

[1] State v. Bank of Louisiana (1834), 6 La. 745; Williams v. Western Union Telegraph Co. (1883), 93 N. Y. 162.

[2] McNab v. McNab & Harlan Mfg. Co., 62 Hun. 18, 16 N. Y. Supp. 448, affirmed in 133 N. Y. 687, 31 N. E. 627; Laurel Springs Land Co. v. Fougeray (1893), 50 N. J. Eq. 185.

[3] I. M. Wormser, *Disregard of the Corporate Fiction and Allied Corporation Problems,* p. 179.

course, is not important. It may wisely differ in different industries and in particular corporations in a given industry. The important thing is to remove a present great harmful uncertainty and to substitute a new element of safety and regularity to the results of common stock investment.

To the same end and purpose other elements of standard accounting practices and definitions should be adopted.

The corporation making these things a feature of its contract with its stockholders should more easily raise the required funds for its capital. The stockholders in such corporation, even if they find it necessary to sue because of undue accumulation and non-distribution of earnings, will have something quite definite on which to base their claims —a basis which the courts must respect, and to which it is no doubt safe to predict they will strive to give effect.

Chapter XV

MORE AND BETTER INFORMATION FOR THE STOCKHOLDER

THE typical stockholder is a stranger to the business of his corporation. The very essence of the corporate form of government—like a republic of checks and balances of power—provides for delegation of authority. When authority is left exclusively to others it is to be supposed, from the very nature of things, that the inactive will drift more and more into a lack of knowledge as to what is going on.

Mr. Justice Holmes of the United States Supreme Court[1] recently said: "A standing criticism of the use of corporations in business is that it causes such business to be owned by people who do not know anything about it. Argument has not been supposed to be necessary in order to show that the divorce between the power of control and knowledge is an evil." This is part of a dissenting opinion in behalf of a Pennsylvania statute, evidently aimed against the chain drug store. The statute provided that "no corporation, association, or copartnership shall own a pharmacy or drug store, unless all the partners or members thereof are licensed pharmacists." The majority of the Supreme Court holds this act to be unconstitutional. Other laws of Pennsylvania require the management of the corporation by a registered pharmacist, and that no physician's prescription may be compounded except by a registered pharmacist. The majority of the court could see no relation between further protection of the public health and mere stock ownership.

[1] Liggett Company v. Boldridge et al (1928), U. S. Sup. Ct. No. 34, October Term, 1928.

"We take judicial notice of the fact that the stock of these corporations is bought and sold upon the various stock exchanges of the country and, in the nature of things, must be held and owned to a large extent by persons who are not registered pharmacists. If detriment to the public health thereby has resulted or is threatened, some evidence ought to be forthcoming. None has been produced, and, so far as we are informed, either by the record or outside of it, none exists. The claim that mere ownership of a drug store by one not a pharmacist bears a reasonable relation to the public health, finally rests upon conjecture, unsupported by anything of substance."

The plea for more and better information is not based on the belief that the average small stockholder of today is any better equipped to receive and digest such information than was his predecessor stockholder of yesterday. Nor is it because he shows any marked eagerness for such information. The belief is that more and better information will be useful to the vast army of analysts, statisticians, accountants, and experts who stand ready to study the information furnished, and to select and interpret for the benefit of the stockholder.

When we speak of information in this connection we usually mean financial information—information relating to values. Attention is now being directed to much larger fields. An example is afforded in the laboratory developments in industry. Note the observations of Maurice Holland, Director of the Division of Engineering and Industrial Research of the National Research Council:

There has been a distinct tendency in several directions recently, to accord the technical development of an industry or a company its rightful place. Bankers are commencing to be concerned not only over the ordinary forms of insurance and the usual legal safeguards but over the matter of insurance for the actual life of the business or of the industry in which it operates. The banker wishes to know just what research is

carried on so that the business may always be sure of its place and not be risking great loss or elimination through a competitive discovery.

Similarly, some of the leading economists have come to realize that the results of research may change the entire complexion of an industry. The statisticians recognize that it is no longer safe to report on the condition of a specific company, its earnings, assets, management, &c. They must also include a survey of the industry from the technical angle, how it is prepared to build sales in the future through its research investigations to discover new products or new applications for its present manufactures.

The ignorance of the average stockholder regarding the affairs of his corporation has in no appreciable degree been negatived by statutory requirements of reports. It is the day of questionnaires—of filling out forms. It is the day of words and figures. It is the day of saying *everything*. In short, it is the day of saying *nothing*—that is, nothing of real illuminating value to stockholders and others having vital interests. The average corporate report is "as dark as the inside of a cow," says Professor Ripley. And Wall Street agrees with him in the main, the exception of railroad reports and of the United States Steel Corporation, General Motors, and a few others, merely giving point to the argument, as the exceptions that prove the rule.

After pointing out the adequacy of railroad reports and of institutional banking to their shareholders, Thomas W. Lamont, of J. P. Morgan & Company, refers to publicity for public utility and industrial corporations, and says:

Professor William Z. Ripley, of Harvard, a high-minded scholar whom many of us are proud to call friend, has taken up the cudgel in behalf of more complete corporate publicity for industries and utilities, and also against certain practices which he has deemed detrimental in general to the stockholders' interests. I shall not attempt to argue in detail Professor Ripley's theses. I might disagree with him on some of them; on many others I should undoubtedly agree. Certainly, I should say, on the whole, that his utterances have had the distinct advantage of arousing much illuminating discussion on the whole question.

No one, however, is wise enough to lay down a general and sweeping

rule that should apply to all industrial corporations. For instance, "pitiless publicity" is hardly the sort of publicity that should be generally applied. The publicity should be adequate and not misleading, but if one means by "pitiless" that it is to be hostile one is almost sure to do harm to the corporation, and, therefore, to the interests of its stockholders.

Over a quarter of a century ago the United States Steel Corporation, formed largely through the efforts of the late Mr. Morgan, adopted with his approval the policy of giving its stockholders as much or more information about its current operations than was required of the railroads. There is no doubt that because of his previous experience as a banker for railroads Mr. Morgan realized the great value of corporate publicity—value to the banker, to the stockholder, to the public, and therefore of inestimable value to the railroad itself.

That this conception had to do with the Steel Corporation's adoption of a clear and frank policy of publicity goes without saying. How many times since 1903, when the corporation's first annual report was published, has Judge Gary, the wise head of the Steel Corporation, made it clear that this idea of adequate publicity was in the forefront of his policies for the upbuilding of this vast and complex property?

So far as concerns this particular corporation, what has been the result? Certainly this company's policy of open and detailed publicity must have borne some weight with the United States Supreme Court when the latter exempted it from the verdict of dissolution, a verdict visited upon several other great industrial companies. The financial strength of the Steel Corporation forges upward year by year; the earnings are stable, and its common stock is distributed among more than 140,000 investors, including 43,000 of its own employees. Its credit is of the best. "Steel common" is a so-called leader upon the Stock Exchange.

There is small chance for the so-called insider to profit by purchases or sale of its shares, based on advance knowledge of unusual gains or recessions in its business, because the company's month to month record of unfilled orders is open for the world to see. Could there be a more striking example of the extent to which adequate publicity has added value to the inherent strength of the company's day-by-day management of production and distribution?

Judge Gary was proud of his part in the publicity policy of the United States Steel Corporation. Said the interviewer

(Forbes, April 1, 1927): "In all your eighty years of achievement what in your opinion has been your biggest and best job?"

Judge Gary considered the question carefully before replying. Then he said:

"Helping to introduce the present system of candid publicity into corporation affairs.

"Of course," he added, "I was only one of many. Nobody does anything single-handed. It is only by cooperation that great human ends are achieved. But I am very happy today to have had some part in that great change. The people have a right to know how the people's business is being carried on; and the more they do know about it, the better it will be for the business. *Big business like human life cannot thrive properly in the dark.*"

General Motors has for one of its slogans, "Stockholders are entitled to know." It mails to stockholders a quarterly financial statement, and at the end of the year issues a complete financial review in the form of an annual report. With the dividend checks is a booklet telling stockholders something they ought to know about General Motors. I understand that the reason the City Service Companies initiated the payment of monthly dividends was the opportunity thus afforded to furnish the stockholder with frequent reports.

It is clear that each business must be a rule unto itself with respect to what kind of information will be helpful. But is there not always available the service of several skilled in that business, who know and can set up the proper standard for that business? I find in my files this clipping from the *Engineering and Mining Journal* for July 23, 1921:

> The paucity of information given stockholders of this gigantic mining corporation (Anaconda Copper Mining Co.), $116,562,500 capital stock and $50,000,000 bonded indebtedness, is amazing. If you were an intending purchaser of Anaconda stock, or any other mining stock for that matter, what questions would you ask about the affairs of the company?

Wouldn't it be well to know what ore reserves the company has? What it has cost to produce copper, lead, and zinc? How profitable or unprofitable some of the manifold subsidiary activities of the company have been? What policies the directors have pursued in the development of the company's activities? One can search in vain through the few pages of Anaconda's report for a clue to answer any one of these questions. Page follows page giving such information as "No. 2 air shaft was sunk an additional 120 ft." "A new roof was placed in the main hoist house of the West Colusa Mine"; that "the sawmills cut 92,865,620 ft. of lumber and purchased 358,115 ft., of which 38,185,389 ft. were shipped"; that "the survey of the proposed pipe line (Andes Copper Mining Co.), was finished in May, 1920." The really essential matters, the relation of the various units of Anaconda's operations to the whole, are omitted, and the intending purchaser will find naught to guide him in making an intelligent deduction about the company's activities.

The writer speaks of contrast of the above with British mining reports, South African, and otherwise compliments the comprehensive data furnished by Hayden Stone & Company in connection with Utah, Nevada, Roy and Chino, saying "anyone desiring to investigate the advisability of purchasing any of these stocks has a wealth of information available which he can readily supplement by reference to the individual company reports." And then makes this significant remark:

These prospectuses can only be prepared when mining companies believe in freedom in supplying financial information.

This critic, I believe, speaks more wisely than he knows, for here is the *keynote, the real solution to the whole problem*—voluntary action, from the inner conviction that it is the right, the proper, the only course to be pursued; not the attempted forced compliance with some set legislative demand, *but belief* in supplying financial information. How else can we ever have real illuminating information? Answers to specific questions cannot cover the peculiarities which every individual business must have. And how can "evasive" answering ever be prevented on the part of an un-

willing witness? You cannot compel a singer to sing or an artist to paint—the one may make a noise and the other a daub, but the reality can only be produced *voluntarily* by him who *wants* to sing, by him who *wants* to paint. Only from the corporation that *wants to report* will there ever come the real light that is needed.

What are the excuses for silence? Generally, that information will be valuable to competitors and therefore disadvantageous to the corporation and actually against the real interests of the stockholder. That such information should not be disclosed must be conceded. The rule seems to be stated correctly as follows: The stockholder's "right to information ceases at such points at which publicity would serve to imperil his equities by divulging such information as would place his company at a disadvantage with competitors." But what would be such information so peculiarly valuable to competitors? A list of customers, prospective sales plans, secret process of manufacture, experimental work on inventions? Nobody asks that these be disclosed, so far as I know. The most insistent demand is for frequent showing of assets, earnings, production, explanations of conditions in the industry as they appear to affect the company, general plans for future growth or of protection of the property. Excuses for silence on the ground that information would be helpful to competitors should specify more exactly why, and should also be accompanied by as much information as possible—not in violation of the conditions. Otherwise those making such an excuse must expect to receive every presumption against them and the possible belief that conditions concealed will not bear the light.

Audits by public accountants—appraisals by appraisal companies or by experts—as safeguards and checks upon corporate condition and conduct are well understood, and their adoption may be expected to become more general as condi-

tions advance toward more and better information for the stockholder. These pertain to financial condition. I propose the adoption of an additional form of audit of wider import, namely, the legal audit. (See suggestion in Chapter XI relative to legal opinions directed to proposed investors.) I suggest that an attorney or firm of attorneys other than that regularly employed by the corporation be retained for the purpose of, let us say, annually, examining the corporate records, including all minutes of meetings of stockholders, directors, executive or other committees, also contracts, transactions, and methods, deemed to be of importance by such attorney or attorneys. Officers should be individually questioned when deemed necessary, the regular counsel of the corporation should be given ample opportunity to explain and to justify any policy or opinions or advice which he had given to the corporation during the period under examination. The auditing attorney or attorneys should then render an opinion of approval, qualified approval, or of disapproval from a legal point of view of matters deemed to require criticism, or to which attention should be directed. It will probably be advisable that such opinion or report be submitted to the officers and directors before being disclosed to stockholders. Omissions may be supplied or mistakes may be corrected on such outside advice. Eventually copies of the legal audit, revised, so as not unnecessarily to raise questions about matters which had been corrected or explained, should be made available to all the stockholders. This could be done either by mailing copies to all, or by making it known to them that a copy will be sent upon request.

While we are talking of more and better corporate information, recent amendments to the English "Company Law" should be considered, for the suggestions they contain:

Under the new law every prospectus inviting subscriptions will have to set forth clearly the voting, capital, and divided rights of the dif-

ferent classes of stock and must carry a certified statement of earnings and their distribution.

A full prospectus must accompany each form of application for shares, the new law declares, but abridged prospectuses may be published in case the complete statement is available for inspection. All relevant information as to the company's affairs must be contained in the full prospectus.

The law also provides that when a debenture issue is made in connection with purchase of a business a three-year record of that business must accompany the prospectus. In case the company has been in business less than three years the record must cover the entire period of existence.

It enables shareholders to have free access to the figures of the company.

It requires all balance sheets to give the profits and losses of subsidiary companies.

If a company fails to keep a register of the names and addresses of shareholders, it will be fined $25 a day until such a list is prepared.

If a company goes into liquidation and it is proved that proper books of account have not been kept, every director who connived at the default will be liable to imprisonment for one year.

The attitude of Judge Gary toward inside information is briefly told by John T. Flynn (the *Forum*, October, 1928):

Judge Gary worked out a scheme of preparing the financial statements of the corporation (U. S. Steel) in secret, so that not even he knew their whole import until the comptroller put them together at a meeting of the board. It was then after three o'clock and the market had closed, the statement being given out in Wall Street at the same time as to the directors. A devout and outraged howl went up among the directors at this. "What! Are we to have no advance information about our own affairs so that we can use the information on the Street?" Mr. Henry Frick was especially indignant. He had always enjoyed this privilege. But Judge Gary held fast to his guns. He insisted that they were not dealing with "our affairs" but with the affairs of their stockholders, which were a sacred trust; and that the director-trustee who went out into the market and, with advance information, bought shares of stock from the stockholders he represented, was guilty, to put it mildly, of a breach of trust.

At the annual meeting of stockholders in 1927, referring to the stock dividend and increase of cash dividends, Judge Gary said:

> It is one of the happiest thoughts in my mind that, as far as I know, no insider, no official, no director, no member of the finance committee, no stockholder, however large his holdings were, tried to make or has had a chance to make any money out of this proposed change. He could not know what was going to be done until the finance committee and the board of directors passed upon the question and it was given to the public so that it could act before the stock market opened the next day.
>
> I do not boast of that, I do not claim that it is a particularly honest act; but I believe that a great many corporations have been conducted in such a way as to give insiders an advantage over those who are not on the inside. And I deprecate it, I do not believe in it, I detest it. When the management of a corporation treats the subject in the right way, I do not consider it an act of special merit, but I do claim it would be a dishonest thing for them to act differently.

Professor Ripley divides reports into several classes and types. We take the liberty to enumerate and to condense his classifications as follows:

(1) The pictorial type. "Emblazoned with gilt or colored reproductions of one thing or another, on large sheets of heavy glossed paper, they are pleasing to the eye. Yet colored pictures of factories, brightly lighted at night—as some of them must well have been in view of their extraordinary success—tell no more tales. What an extravagance of good paper and ink, about as nutritious as some of the advertising displays of ham and eggs or other standard articles of daily consumption in the popular magazines." I think you are wrong, Professor, the pictures are good and well worth while. I admit that they should not be expected to displace "the facts and figures" you want. But most of us are deeply interested in the business as a living thing; we like to think of the smoke from the chimneys—the hum of the machinery—and the lights in the windows at night.

The pictures help. Few stockholders are professors or of the professional type. See discussion of classification of stockholders by occupation in Chapter VII of this book. Your average stockholder is the average human being, and he likes pictures. So-called "facts and figures" do not make the same impression on him as they do on a college professor. But then, as you have seen in Chapter III, the fact that romance of business has the same appeal to stockholders as to other human beings is apparently overlooked by nearly every one.

(2) "The leaflet type done on a single folded sheet of paper. This 'tuppence ha' penny' variety, once common, is happily by way of passing out. Cotton mills are still in this stage, again with nothing but a balance sheet, and no income statement at all. Some of the new investment trusts, which ought particularly to disclose full information about their holdings, have got no farther." This criticism, of course, refers to annual reports. Personally I greatly appreciated the very brief monthly reports I once received from a successful mining company—they were printed on the back of a postal card.

(3) "The pompous but empty type, suggestive of President Wilson's pithy distinction between men who grow and those who merely swell with the advance of years. Such reports remind one of those little men who not infrequently puff themselves up in a manner to make up for their abbreviated build."

(4) " 'Business condition' type, devoting much attention to things in general and but little to their own affairs in particular."

(5) "Reports, like Tristram Shandy, 'all obfuscated and darkened over with fulginous matter.' To the uninitiated they may tell too much that is not so, or too little of what they ought to tell."

(6) "The truly informative type of official report, which

fortunately is coming more and more to be recognized as not only good form, but the best of business as well. The United States Steel Corporation, now owned by 179,000 people, has from the outset followed the precept, well stated recently by Judge Gary, its president. 'Corporations cannot work on a principle of locked doors and shut lips.' From the first annual statement, outspread over entire newspaper pages in 1903, down to the present time, its record has been consistently admirable. The General Motors Company, first in its industrial class the world over, is a worthy second. It has 56,000 shareholders. And in the field of public utilities the Philadelphia Company, and the Consolidated Gas, Electric Light, and Power Company of Baltimore offer prominent examples of reports as simple and understandable as their complicated structure permits. Another model statement, suitable for smaller concerns, combining full publicity, made as intelligible as possible, with pictured evidence of the development of the business, is that of the Dennison Manufacturing Company, with its 800-odd stockholders."

An interesting example of what can be done to make the corporate condition more clear, is the form of balance sheet initially furnished, I think, by the Corn Exchange Bank of New York. A copy is contained in Appendix E, as is also a somewhat similar form used by the Prudence Company.

Chapter XVI

REAL *VERSUS* PERFUNCTORY MEETINGS OF STOCKHOLDERS

WHY do stockholders habitually fail to attend meetings? A stockholder gives this rather cynical but comprehensive answer: "What's the use? If you believe in the directors, why waste your time when a proxy is so easy to give and meets all requirements? If you don't believe in the directors, attendance will likewise be a waste of time. You can accomplish nothing and will be regarded as a 'blackmailer,' especially if you make any protest or contrary effort." This seems to put the matter rather strongly and bluntly, but in the main, it is unfortunately true. At the usual meeting the majority or additional amount required to vote has been canvassed and is represented by those in control in person or by proxy and is already prepared, resolutions are already drawn; in fact, the minutes are often all prepared in advance and everything is "railroaded" through. It is a cut-and-dried affair and everybody is anxious to get it over with and get home. The minority stockholder who starts to ask questions is a "nuisance," or a "nut," or a "trouble maker." Immediately suspicion arises that he may be a so-called "corporate blackmailer," anxious to make as much trouble as possible, to get the company's affairs into the newspapers in an unfavorable light, with intimations that there is trouble brewing, perhaps to lay the foundation for litigation that will delay if not defeat the program of the majority.

Before the Pujo Committee on June 24, 1913, James J. Hill, in speaking of the interest taken by stockholders in the election of directors, said that in thirty years no stock-

holder so far as he could remember had attended the meetings of the Great Northern Railroad unless he wanted to make trouble. There was one man known to him who actually boasted that he made a living by levying blackmail on corporations as a minority stockholder.

All of us, I think, who have to do with corporations, entertain the same attitude and often because it is amply justified. Not long ago, I was charged with the responsibility of assisting as counsel in the reorganization of an oil company. Its affairs were in a mess. A recapitalization was arranged eliminating the preferred stock with its constantly growing and insupportable accumulation of unpaid dividends. A voting trust was established, a board of directors was elected representing the creditors, an investment banker disposed of a substantial part of a new first mortgage bond issue, proceeds of which were being used to discharge the smaller and more immediately pressing obligations, new leases were being drilled and our troubles seemed in a fair way toward solution. Meanwhile a regular annual meeting of the corporation was to be held. With a large majority of the voting stock held by the voting trustees, it looked as if this meeting would be a mere perfunctory affair. I prepared the necessary, formal minutes and forwarded them to Tulsa. I was called by long distance on the day of the meeting and informed that a certain person had appeared with a proxy from a stockholder who had not deposited his stock under our reorganization agreement, and threatened to make trouble. I advised that the meeting be adjourned to a date far enough off, so I could make the necessary trip. I then made request for rush reports by a credit agency and also by a combined credit and detective agency commonly employed in Wall Street. I found that the "attorney in question" was a member of the bar of Washington, D. C., that he owed money right and left, and that at present he was

making a specialty of prying into the affairs of corporations in difficulty, and was either bought off or found a job for himself in the reorganization. When I arrived at Tulsa, more than enough further detail was learned to make it plain that we were the new victims, and that this fellow's talk and threats would have to be cut off. Any rumors at this time that our plans for rehabilitation of the company's business would not go through completely or that they would be delayed in the courts would be absolutely ruinous. I admit that I purposely "railroaded" the rest of the meeting, in order permanently to adjourn as soon as possible. Subsequently this obnoxious person in association with other attorneys in Chicago had the unmitigated audacity to file a bill in equity in Delaware for a receiver, alleging failures on our part to comply with statutory requirements in amending the company's certificate of incorporation, in spite of the fact that complete compliance was *all a matter of public record* in Delaware.

In contrast with our American experience we hear frequent reference to the large attendance, real discussions, and results secured at stockholders' meetings in England. The *Wall Street Journal* says:

> Stockholders' meetings are held in London in a hall that accommodates two thousand people and it is frequently crowded. There is always a good attendance. The directors sit on the platform, with their chairman, and answer questions after the report has been read. The questions are usually shrewd and searching, and woe betide the director who tries to evade them. Such meetings are well reported in the newspapers, especially if the company is a prominent one. The result of this publicity is that the will of the stockholder tends to prevail and has certainly had the result over a long period of years of establishing a liberal dividend policy.

That such meetings are sometimes held in this country and that good results may develop from this method of attendance and free and open questioning and discussion by stock-

holders is indicated by the report of the annual meeting of Childs Co., contained in subsequent pages of this chapter.

How the average stockholder feels about attending meetings today is interestingly told by John T. Broderick, in *A Small Stockholder:*

I have attended several of these annual gatherings, but as an observer and listener only, for there has never seemed to be any way in which I could lend a hand with the proceedings. At the last meeting that I attended I asked a teller who sat near me if, so far as he knew, there was anything that I could do that would at least show my willingness to be useful. He replied that directors were to be elected and that, as a registered stockholder, I was entitled to vote. That gave me a sense of importance, which, however, did not last very long, for I saw presently that the directors whose terms of office were about to expire had in their possession proxies for over 70 per cent of the outstanding shares, and had already decided to re-elect themselves. I had no cause to question the wisdom of their decision, for, so far as my knowledge went, they were all men of probity and business experience. So I refrained from voting, not from pique, but because it was patent that my vote could not influence the result. From a subsequent analysis of the case I was persuaded that, after all, I had unconsciously participated in the election of the directors, because the funds of the corporation, a small share of which was mine, had been used to defray the expense for postage, stationery, and labor required to obtain the proxies. That, however, is a technicality, the consideration of which by a layman would lead far afield. Corporate procedure, with its intricacies and host of anomalies, is completely intelligible only to the erudite and able lawyers who have the task of its interpretation, and to a few cloistral pedagogues who can see rhyme and reason in any riddle. What I am trying to calculate at the moment is the measure of interest that there is for me in any meeting of corporation stockholders which I am entitled to attend. In fact, while I am unusually ill at ease in the presence of death in any form, if I were obligated to choose between hying to one of these corporate powwows, with its arid ceremonial, and going to a funeral, with its moving solemnity, there is no doubt that I would pick the funeral. At a friend's obsequies one may at least speak a consoling word to the widow, if he knows how, and possibly serve as a pallbearer. Being a pallbearer is having a job to do in which one may take pride in doing well.

Observe that the writer just quoted with his gentle sarcasm and irony, is withal painfully precise. He refers to the lack of interest "in any meeting of corporation stockholders which *I am entitled to attend.*" May we infer that there are other meetings not necessarily contemplated in law where a favored clique constituting a majority or working nucleus toward a majority, carry on? Perhaps so. And why not? No doubt such meetings have the vitality of reality in them. They should have. The shame is that those thus vested with legal control do not see how much better they, as well as the corporation—the stockholders as a whole—would be if this spirit of reality were imparted to and made a part of formal legal proceedings. When law becomes mere formalism it is time to quit. Two kinds of meetings—one required by law and absolutely of no use except to count votes already counted—and the other not required by law, and full of life which the importance of any business in hand may demand.

The somewhat bewildered attitude of a certain type of stockholder toward the formalism of the usual corporate meeting, and a supposed necessary presence of corporate minute book and seal is illustrated by two experiences. The first occurred in the early days of my practice in St. Louis. While I was absent from the office, a young man client, attending a corporate meeting in another building, became highly excited over what he deemed to be an attempt to freeze him out of his interest in the corporation. He grabbed the minute book, tucked it under his arm, dashed out of the building, and ran down the street, a crowd yelling "Stop Thief!" like the pursuers of Oliver Twist. Arriving at my office, he bolted the door to the hall and asked for me. My bewildered secretary informed him that I was in Chicago. He then rushed to an open window on the areaway and shouted, "I want a lawyer! I want a lawyer!" Of course,

his plea was soon answered. I often wondered whether some of my friends assumed from the fact that the cries came from my office that I was in some altercation with a client who had suddenly become aware of my limitations.

The other incident took place after I came to New York City. Strong opposing factions at a stockholders' meeting of a film concern, now a leader in the moving-picture world, became quarrelsome. In the welter of words one of the stockholders took the corporate seal from the table and threw it out of the window. Fortunately it missed all the persons passing on Broadway and merely made a dent in the cement sidewalk. I suppose that stockholder labored under a delusion that the presence of the seal, like some sacred ikon, was necessary to the validity of the proceedings. By throwing it away, the meeting would *ipso facto* adjourn. It did not. The fight went on and only ended in the courts.

It has become so customary for stockholders' meetings to be so devoid of personal attendance or participation in discussions that the following was a headline in the New York *Herald Tribune* in 1927:

> Erie Investor Asks President About Dividend.
> Railroad's Annual Meeting Enlivened
> by Discussions over Preferred,
> Common Stockholders'
> Interests.

The article so headed is set out in part in Appendix F.

The annual meeting of stockholders of Childs Co. in 1928 should be noted because of the general interest in and discussion by stockholders of the company's policy. One of the protesting stockholders subsequently published a letter in the public press, following up his protests. Then the company announced a general change in policy as to foods served. So it would appear that stockholders' suggestions were valuable; also that the method of discussion and public

protest was effectual. As a concrete example of the kind of discussion which can take place when encouraged and permitted, we reproduce the minutes from the *Wall Street Journal* of March 5, 1928:

The meeting was well attended and lasted two hours. Considerable discussion arose regarding the company's operations. In the absence of William Childs, president, the meeting was presided over by S. Willard Smith, vice-president, who replied to various questions put forth, many of them critical in character.

Among those to inquire on a number of points, particularly with regard to management of the company, was L. A. Mathey, who said his family had been stockholders of Childs Co. since its formation and any criticism he might put forth was intended only in a constructive light. In reply to his query as to the company's earnings for January, Vice-President Smith said they were approximately half of those of January, 1927, which amounted to $280,000 before depreciation charges. Mr. Mathey expressed the opinion the lower earnings, and particularly the smaller net amount earned in 1927 as compared with 1926 were due largely to changes in the last year or two in the policies of the company's restaurant operation, such as the failure to serve meat, stressing the consumption of vegetables and "health foods," and similar ideas which, he felt, had tended to influence many of Childs' patrons to eat elsewhere.

"The public doesn't seem to care whether it gets dyspepsia or not. You have to give them what they want," he said. These remarks met applause.

A woman stockholder, Charlotte Currie, said she represented the views of numerous downtown business women who were eating elsewhere than at Childs. She said the company's stores there had lost business lately.

E. J. Zwilling, representing substantial Childs' stockholders, criticised the manner in which it seemed to require "so much longer for Childs to get a restaurant in operation than it did other systems, once they started to do so." He commented on other similar points with which, it seemed to him, the stockholders could find just fault, and intimated some "movement might be launched to prevent injury to stockholders' interests."

Other criticism centered about certain ideas of the "management" in the operation of the restaurant business. One stockholder or other volunteered the idea that an advertising policy would help; that it was very nice to have the new stores "fitted out like palaces," but they ought

to be able to draw trade as well; that the "Childs' name should be displayed as prominently as in the past, since that was the drawing card to most customers, particularly out-of-towners"; that "water should be served with meals as in the past"; that "Childs' prices were too high"; that the New Year's Eve $1 minimum check "did the company much more harm than good," and that the company is "a one-man organization."

To all these Vice-President Smith replied that the "management" (presumably meaning William Childs, president and general manager) was responsible for the changed ideas in operation; that he and his brother—the late S. S. Childs—had put various ideas into effect in the past which had been criticised, but which had invariably worked out for the best interests of the company in the long run.

"In fact," he added, "the Childs brothers' judgment has been wonderful."

It was evident the stockholders wanted to hear from President Childs, personally, regarding the future policies, and a motion was adopted to the effect that at the close of the meeting "adjournment be to a date within the next three months, when President Childs should call a meeting of stockholders, at which time he would be present to answer queries." At this point Chester Lane, of Lane & Logan, lawyers, inquired if it were the desire of stockholders to hold up the election of directors, and being assured that it was not, the ballots were cast.

In reply to a query on the Boos System, acquired by Childs as of January 1, 1927, Mr. Smith said it had lived up to expectations, the 1927 net amounting to $362,700. The Coney Island Boardwalk store income in 1927, he said, was below that of the previous year.

"Don't judge our future," he commented, "by the last half of 1927. Our outlook in the near future seems good."

Answering a query as to why depreciation charges were $200,000 heavier for 1927 than for 1926, he said it was the company's by-law requirements to charge off 5 per cent of the cost of establishments, and these were greater in 1927 due to more property owned.

In response to questions as to the wisdom of acquisition of an interest in the Savoy Plaza Hotel by Childs Co., Mr. Smith called upon W. A. Barber, of Barber, Fackenthal & Giddings, lawyers, who is a director of Childs Co. and of the Savoy Plaza Corp. Mr. Barber said Childs' holdings were nearly 50 per cent of the capitalization of the Savoy Plaza Corp.; that the Savoy Plaza Hotel since its opening on October 1, last, had been renting 15 per cent higher for rooms and 10 per cent higher for stores than had been expected; that at the present rate of operation

dividends could be expected on the preferred stock by January 1, next. The property, he said, was one of the choicest morsels of real estate in the city; its acquisition was considered a good transaction and it was probably worth between $10,000,000 and $11,000,000 today—compared with cost now standing at $7,500,000.

Replying to a question as to Childs' real estate and lease holdings Mr. Barber said it was generally conceded that Childs was possessor of some valuable realty holdings acquired at much lower figures than which they could be obtained for today. While leaseholds, good will, etc., were carried on the books at around $4,700,000, the good will item, he said, could be written down to $1 and leaseholds would still be worth at least the total figure. On the matter of Childs' real estate dealings, stockholders were willing to agree with the management that "that end of the business couldn't be run much better." It was the company's restaurant business, they felt, that needed improvement.

The United States Steel Corporation has stood out prominently as a company which encouraged attendance and discussion by stockholders at annual meetings. Statements, including remarks of stockholders, are frequently circulated by the corporation after a meeting. At the meeting held April 17, 1922, Judge Gary said:

I should like to deal for a moment in personalities. We have been meeting many of you year after year. You have been steadfast and faithful, and intelligent in what you have said and the suggestions for improvement which you have offered from time to time. We know your faces, your names, and your holdings. And I assure you we appreciate your disposition and your presence at these annual meetings.

This corporation has become a large and friendly one of business men and women. And to have the support of such as you is of more benefit, and of more real gratification to the officials than even the contribution of money could be.

What right have we to expect that real management participating stockholders can improve the business? Well, in the first place many corporations are suffering from dry rot, or from some overwrought use of new so-called efficiency ideas—or there may be too much red tape—too much dupli-

cation of effort. Informed stockholders looking in occasionally from the outside will see such as these and many other things which go unobserved by those who have grown stale on the job. And you must remember that your informed stockholders should be just as powerful as his idea and his ability to express it—his strength is not measured by the number of shares he holds. Is it not fair to assume that many a small stockholder, under proper stimulation and encouragement, will often contribute thoughts of more far-reaching importance to the business than his brother richer in shares, perhaps, but by no means necessarily richer in brains? Ideas do not turn on majorities of votes or on the size of the bank balance. "An idea belongs to whoever understands it." There is nothing so valuable and nothing more democratic. "There is something," said Victor Hugo, "greater than armies and that is an idea when its time has come."

Then, too, there is the value of controversy, not the threatened legal controversies of the so-called blackmailing stockholder, but the intellectual controversy giving expression in differing opinions. We want unity in the corporation—it is true—but we do not want a dead unity created either by indifference or by imperial command. We want the unity which comes after controversy. The *Forum Magazine* says:

> Controversy is essentially creative, and debate is the mother of democracy. Opinions that have in them any life whatever in this country are not handed down, sealed, signed, and delivered by remote authorities. They come up hot from the clash of conflicting ideas with all the dust of the struggle still upon them.

When an otherwise smug and well-settled management backed by a long-standing majority, is challenged by a well-informed minority stockholder, and has to stand up and fight for its opinions, we will have better opinions, better management, better corporations. An intelligent majority

should encourage the bringing on of such a condition. It should be pleased to see its selection of management heckled and forced to justify itself. Perhaps there is on many a long list of small stockholders many an expert in common sense whose opinions would be of inestimable value. But of these things we can only speak supposititiously, not from authority. We don't know; we can only surmise. The experience with a real democratically administered business corporation is thus far limited; the experiments are few.

Chapter XVII

PROTECTION OF STOCKHOLDERS AGAINST SPURIOUS SHARES; AGAINST LOSS OF CERTIFICATES

The institutional transfer agency has greatly facilitated the coming of the era of the small stockholder. Two outstanding reasons are at once apparent. The first is the taking of this detail out of the hands of the inexperienced and placing it where it can be efficiently and economically handled. Otherwise wide distribution among relatively small holders would be too expensive to be encouraged and would become a burden to be avoided. The second reason is the greater regularity and authenticity which the independent transfer agency—particularly the trust company and the bank—has added to make the evidence of corporate interest in reality a true security and not a mere name.

My reason for discussing the transfer agency is not so much these things. It is my more serious purpose to direct attention to the possibilities which their facilities offer for a closer study and classification of the stock list. The use of addressing machines will particularly aid in the making of particular lists of stockholders of various kinds for the purpose of soliciting aid and business in stockholder-customer campaigns. There is also the possibility that a greater appreciation of varying degrees of mentality of various classes of security holders will lead to different methods of contact between them and the management, additional forms of reports, and explanatory executive correspondence.

To furnish security holders with duly authenticated evidences of their rights and to keep a record of their names and addresses is a duty which corporations discharge with

apparent ease and surprisingly little trouble to the public. This is due in large part to the fact that transfer agency and registrarship is for the most part delegated to banks and trust companies experienced in the work and profiting by a growing set of precautionary rules and practices promulgated by the New York Stock Transfer Association. Corporations and stockholders generally should know that this association, composed of leading banks, trust companies, and financial houses throughout the United States and its possessions and in Canada, is making uniform and simplified procedure a basis for facilitating registration and transfer of their shares, and in conjunction with the National Tax Association and other agencies is initiating and putting through a legislative program eliminating multiple inheritance taxation of securities.

Moreover, the successful methods of the New York Stock Transfer Association are interesting because they point a way which may profitably be followed in other and additional fields of assisting and safeguarding the corporate investor. The Association in its original form was headed by an attorney, learned in stock transfer work and respected by every one. Meetings of the Association would be convened in the afternoon and discussion had and resolutions passed relating to some new matter, generally a threatened legislative change. The attorney referred to took the chair and usually wholly dominated the proceedings. He had apparently arrived at well-thought-out conclusions and had legal authorities to support his views. Hardly any one else had the temerity to take the floor. Attendance dwindled away. Members ceased to renew their memberships. Then came a new day—or night, to be more specific.

Under the sponsorship of C. A. Luhnow, owner of *Trust Companies Magazine,* a banquet was held at the Bankers Club in the Equitable Building, and a new association was

planned, to be composed of transfer agents and financial houses, as before, but delegates to be those trust officers and others who were actually engaged in transfer work—the lawyer to be completely relegated to the background, only to be consulted after a recommendation, rule, or program of action had been, previously, tentatively considered or agreed upon.

This is the way it works: Suggestions are in order at any time and are sent to the secretary. In due course accumulated suggestions are selected and often reworded by the Standardization Committee. These are sent out in questionnaire form to members. Replies are classified and counted by the committee, advice of counsel taken when deemed necessary, and then the recommendations of the committee are submitted to vote at a dinner meeting of all the members. In the meantime the Executive Committee takes such action relating to legislation or other matters as seems advisable, without loss of time incident to holding a general meeting. The association in this form is a marked success.

Many stockholders fail to appreciate the value of their certificates as evidence of their property. A common practice of endorsing certificates in blank works against the protective value of "registration" in the owner's name. Stockholders, particularly in corporations whose stock is not listed, are frequently persuaded by irresponsible brokers or by others, to endorse their certificates in blank and to let the broker, etc., take possession of the "endorsed" certificate, so that quick delivery can be made should "alleged" opportunity for advantageous sale appear. Such "opportunity" soon appears in a "switch" to some other issue, frequently of no value whatsoever. A valuable service to stockholders will be rendered by writing to the stockholder or by pinning to his certificate, upon delivery, warning advice and precaution in these matters. A form prepared by the writer is as follows:

The attached stock certificate is the evidence of your rights as a stockholder in this corporation. This certificate should be carefully preserved by you in the same manner as you would preserve the evidence of other valuable property. Your safety-deposit box is the best place for it. On the back of this certificate there is a form of assignment. If you sign this assignment in blank, it would make it possible for any person securing it to negotiate it in a manner which might make it necessary for you to invoke costly legal proceedings, even if you discovered the loss before some other person secured a transfer on the books of the company and obtained a new certificate to represent in his name the stock represented by this certificate. Registration in the name of the holder and owner of the stock represented by this certificate is a measure of protection for your benefit. You are cautioned to safely preserve the certificate and not to assign it except to persons in whom you have reason to have confidence, in order fully to benefit from this protection. You are respectfully warned that unscrupulous brokers and others frequently obtain possession of certificates of stock duly assigned for alleged purposes of sale and frequently persuade stockholders to exchange their stock for other stock in which such brokers are personally interested. Before assigning stock and placing it in the hands of such persons, either for sale or exchange, you should first make inquiry as to the standing and responsibility of the brokers offering such service. If no other source of inquiry is at hand, we suggest that you ask your local banker and secure his advice before acting. If there is no public market for this stock you can always secure some information as to the value of the stock from officers of the corporation itself. You would not sign a deed to your real estate without the turning over to you of the proceeds of sale at the time, or the obtaining of adequate security, unless you were doing business with persons of unquestioned standing. Although stock is more readily negotiable than real estate, it may frequently be of greater value and there is no reason why you should not take precautions before parting with it.

If you discover that you have been defrauded, or if you lose the certificate, or if it is destroyed, you should immediately notify this corporation and place a "stop" against the transfer of the stock. You are advised, however, to use every possible precaution to prevent such a loss because in the event thereof any measure of protection will be troublesome to you and may involve legal and other expense, even if effective, and there is always the possibility that the persons securing the stock

may be able to complete the transfer into hands of innocent purchasers, whose claims may possibly be stronger in law than your own.

The following forms are used by the American Telephone and Telegraph Company. The first is attached to stock certificates issued to stockholders other than employees; the second is attached to certificates issued to employees under the Employees' Stock Plan of the company:

AMERICAN TELEPHONE AND TELEGRAPH COMPANY

195 Broadway,
New York City

125 Milk Street,
Boston, Mass.

To Stockholders:

Your stock certificate is a valuable paper. It is evidence of your ownership of stock. It is important to put it away promptly and keep it in a secure place so that it will not be lost, stolen or destroyed. If lost, stolen or destroyed it may be possible for you to secure a new certificate, but the necessary requirements to do so will involve delay and cause you considerable trouble and some expense.

A safe deposit box is the best place to keep this certificate.

H. BLAIR-SMITH,
Treasurer.

AMERICAN TELEPHONE AND TELEGRAPH COMPANY
195 Broadway, New York, N. Y.

The attached certificate has been issued to you under the terms of the Employees' Stock Plan of the American Telephone and Telegraph Company dated May 1, 1921.

It represents shares owned by you in the business in which you are engaged. Your investment is one, practically speaking, in the telephone industry of the nation. It is the result of your systematic saving.

Your stock certificate is a valuable paper. It is important to put it away promptly and keep it in a secure place so that it will not be lost, stolen or destroyed. If lost, stolen or destroyed, it may be possible for you to secure a new certificate, but the necessary requirements to do so will involve delay and cause you considerable trouble and expense.

A safe deposit box is the best place to keep this certificate.

H. BLAIR-SMITH,
Treasurer.

Chapter XVIII

PROTECTION OF STOCKHOLDERS AGAINST LIABILITIES; DOING BUSINESS IN FOREIGN STATES

THE stockholder today has a peculiar and comparatively new interest in what we call "foreign corporation laws." The laws referred to are those statutes of a state which pertain to the admission, licensing, or qualifying within its borders of a corporation organized under the laws of another state or country. To enforce these laws, drastic penalties are provided, sometimes including individual and partnership liabilities of stockholders. These laws also frequently provide for the application of the laws of the foreign state to the "rights" of stockholders of the foreign corporation.

Although these penalties for "doing business" in foreign states without a license have been on the statute books for a long time enforcement to any great extent has only taken place in recent years. I remember when attorneys of the more conscientious type hesitated to move for dismissal of an action by an unqualified corporation, because such a technical defense when the statute afforded it seemed "unfair"—almost like stealing in some instances. How were you going to reconcile securing property or services and then being able "legally" to refuse to pay? This defense is now pleaded every day without "batting an eye." Application of individual and partnership liability of stockholders where a foreign corporation has incurred unpaid liabilities in a state in which it should have secured a license but failed to do so, was so novel just a few years ago as to pass without belief on the part of most conservative counsel or as a highly theoretical idea without convincing legal authority. Today

we find it cropping out with enough frequency to cause real alarm. Surely stockholders in a certain class of underfinanced corporations doing business in a number of foreign states have occasion to keep posted as to the company's policy and action in foreign states.

The policy adopted with respect to compliance with license requirements imposed by foreign corporation laws may thus have a primal importance to stockholders. The attitude of corporations generally seems to alternate between indifference and alarm. Things appear to run along smoothly enough—nothing happens in the state or states in which the corporation is "doing business." Why bother with these troublesome statutes and their endless red tape? Filing certified copies of charters, appointing process agents, filing reports is a nuisance in one or two states and becomes a positive burden when extended to several states. But that isn't all. Look at the fees and increased taxes. Why not forget it all? These troubles are certain, no state may ever fine the corporation for non-compliance. We will see that no litigation occurs in which non-compliance can be pleaded as a defense. The troubles due to non-compliance are uncertain and seem remote. Why look for or think of the "ills we know not of"? Indifference becomes a settled policy. Then all of a sudden like a bolt of lightning comes the shock, generally in the form of a large uncollectible balance. Dispute has arisen. The courts are appealed to for relief—the technical defense of non-compliance with the foreign corporation laws is set up, and the whole balance of the account is lost. Perhaps this happens to some other corporation and the news of it sets up the alarm. The actual loss is so great, or the potential loss on other contracts is so great. A sort of moral panic takes place. Sales contracts, agency agreements, methods of "doing business," statutes and regulations are gone through in a hurry. Out of this whirling dervish dance comes

some wholesale compliance with foreign statutes near and far, regardless of the particular problems or the situation in individual states. The result is the taking on of unnecessary detail and expense. I have witnessed many a corporation qualify in nearly all the states long before "business was done therein." The annual round of reports and taxes thereafter incurred, with no connection with benefits received, help to make the whole affair a meaningless thing.

It is true that foreign corporation laws are confusing and to decide particular problems under them often difficult—to dismiss the whole affair by compliance right and left seems an easy way to avoid a headache. But it costs too much money and too much unnecessary future vexation in the way of reports.

The better corporation will endeavor to comply with foreign corporation statutes where needed, but will save money for its stockholders by avoiding the necessity of compliance when it can. To apply this discrimination recourse may be had to some principles applicable thereto that are definite.

Instead of qualifying as a foreign corporation in the several states, a practice grew up of organizing domestic companies with nominal capital in each state in which it was deemed advisable. This was all right enough when the only protection sought was registration of the name on the books of the secretary of state, as a means of keeping others not associated with the company from coming into the state either as a domestic or a qualified foreign corporation. But when it came to the bringing of suits in the state or to considering liability for income taxes, it was found that these companies were too much of a shell to be of any real service. To accomplish their full purpose such state domestic corporation must keep their own books and actually conduct all the business of the corporation in that state—at least all intrastate business. The practice is too great a nuisance and

is giving way to the organization of a so-called foreign qualifying unit, with comparatively modest capital to keep down state franchise taxes, all of the stock being owned by the parent company. Here, too, realities must be respected and observed. It won't do to have a mere "monkeyin' and maneuverin' " company. That expression comes from the story of the negro janitor, messenger, and general handy man in the office of some Alabama mining companies. There was a company in the office, "The Mining & Milling Company," abbreviated in conversation to the "M. & M. Co." This company was apparently not active in the public eye, but was a mere paper company, used to temporarily hold options or act as reputed owner of certain properties on "tax day." Some one asked our negro friend, "What is this M. & M. Company I hear so much about?" "Oh, that," says he, "am the monkeyin' and maneuverin' company."

An example of advantageous use of holding corporations and subsidiaries for operations in various states is that of the new "Pullman, Inc." holding company of several subsidiaries. Pullman car operations on the railroads are subject to various federal and state regulations not applicable to its manufacturing operations. By segregating activities into that of different companies, each tub stands on its own bottom with respect to regulation and taxation.

Will attempted whittling away, cutting down, or elimination of stockholders' rights in liberal charter-granting states be given effect in foreign states? No, they probably will not be effectual; at least, in some foreign states in which the corporation will do business and in which it sells its stock. This answer will no doubt surprise many. If I am right, it must follow that use of some so-called "corporate advantages" will practically disappear. Nearly all of these corporations secure licenses to do business in foreign states. They do not confine their operations to their own state and

to interstate commerce. As stockholders in protecting foreign states become acquainted with the fact that their attempted belittlement is ineffectual, they will assert their rights as of old and in the courts, if necessary. In fact these corporations will have deliberately laid themselves open to successful application against them of the much dreaded "strike suit" of the "so-called" corporate blackmailer. Certainly attempted elimination actuated by anticipated convenience is not worth much risk.

Recent phases of elimination of stockholders' rights have not at this writing, so far as I know, reached the courts. But early phases of the same thing have, and court decisions have been placed on very broad grounds.

Missouri holds that a foreign corporation which complies with the laws of Missouri in order to do business therein impliedly consents to laws of Missouri protecting stockholders, including the right to inspect the corporation's books under reasonable regulation.[1]

A provision in the by-laws of a Delaware corporation giving "the directors the right to determine when and under what conditions, the examination, if any, can be made," will not be upheld. It is true that a like conclusion might have been arrived at in applying Delaware precedent to the question, but the interesting thing to us, is the ground upon which this Missouri decision is based.

The same underlying idea appears to be involved in decisions of the United States Supreme Court,[2] holding that the naming of a particular state or states in the certificate of incorporation as places in which the corporation will do

[1] State ex rel Smalley v. Sterns Tire & Tube Co. (1918), 202 S. W. 459.

[2] Pinney v. Nelson (1901), 183 U. S. 144, 46 L. Ed. 125, 22 S. Ct. 52; Thomas v. Matthiessen (1914), 232 U. S. 221, 158 L. Ed. 577, 34 S. Ct. 312; American Banana Co. v. United Fruit Co. (1909), 213 U. S. 347, 53 L. Ed. 826, 29 S. Ct. 511.

business has the effect of an agreement to adopt all the laws of such state applicable to the relations between the stockholders and the citizens of such state.

The California Corporation Commission requires elimination of several so-called advantages in the certificates of incorporation of foreign corporations prior to granting permit for the issue and sale of securities in California:

The power given to directors to create an executive committee with full powers of the board is objectionable and will not be accepted.

The power given to directors to limit and restrict the inspection of books and accounts by stockholders is objectionable and will not be accepted.

The power given a majority of the *voting* stock to sell the property and assets of the corporation as an entirety is objectionable and will not be accepted. This usual paragraph should be qualified so that not less than two-thirds of *all* the issued and outstanding stock must consent to such a sale.

All of these objections are based on the theory that they are unfair and unjust to the minority stockholders who in most instances are the cash investors, and further are not in conformity with the California statute which is to the effect that a foreign corporation shall not be permitted to do business in California upon more favorable terms than those granted a domestic corporation.

There is another point to be remembered in preparing the certificate of incorporation of any company which will come into California as a foreign corporation and offer and sell its stock in California, to wit: If it is desired to limit or restrict the voting power of a class or classes of stock, such restriction must be qualified to the effect that such restriction is in force so long only as the dividend requirements

of the class whose vote is restricted are met. The limit of time which the Commission will permit the restriction to stay in effect after failure to meet the dividend requirements has been two years, though in some instances, we understand, the time has been stretched to three years.

Chapter XIX

PROTECTION AGAINST FRAUD

THE era of the small stockholder invites more frequent perpetration of old and new forms of fraud. Consequently there is demanded a larger measure of protection than ever. The small investor is particularly weak because the very size of his investment does not justify additional loss of time and expense of making complaint to public officials and because such a stockholder can the least afford to institute "stockholder's" suits, bring other forms of litigation, or even conduct a thorough investigation. Such action is not prudent from his point of view. It is clearly "the putting of good money after bad money."

All good corporations and stockholders should, under these circumstances, hasten to join forces against the common enemy. What can be done to prevent fraud and totally unnecessary investment loss in enterprises palpably doomed to failure from the start? What can be done to simplify and perfect present methods? What new methods are worth trying? What can be done to make the new nation of small stockholders astute, without destroying the taking of risks incident to progress which goes hand in hand with necessary experiment? How shall the increasing large army of small investors be taught the hard lessons of discrimination and judgment? When will the typical investor acquire that look and attitude that goes with the person who knows the price of eggs—does not intend to be "done"—will look reasonable chances in the face and only take them when he knows in advance that he can suffer total loss without disaster?

All corporations directly and all stockholders indirectly

are concerned that these problems be solved as soon as possible. Legitimate corporations require and desire that all money be available to their requirements and not diverted to the illegitimate. Stockholders need protection against the machinations of skillful confidence men against whom they wage an unequal contest, because of their lack of skill, knowledge, and general guilelessness. Less obvious but fundamentally more potent a consideration is the depreciation in value of all security investment where corporate fraud and the sale of corporate securities are left unprotected and unregulated. The more easily any form of property is simulated, the more easily that the false can be passed for the real, the less valuable it becomes. Conversely protection to property adds proportionately to its value. When this is more thoroughly understood, the interest of all stockholders and especially the small stockholders, will stand out so clearly that every effort to stamp out corporate fraud of every kind will receive a new urge and a new impetus which should go far toward stamping out these evils.

It is only too true that corporations and fraud are frequently found together. But more often than not, the presence of fraud in the vicinity indicates that the corporation is a victim and not an accomplice.

The corporation supplies a highly respectable method of doing business and of holding title to property, so the rogue adopts it now and then as a hiding place and a pretense, where he can go unrecognized and hidden away, at least temporarily, from detection. It is a fence behind which the guilty may carry on. Its use among a certain gentry is common practice like false whiskers, stopping at fashionable hotels, wearing fine clothes and diamonds, talking in a commanding tone to head waiters.

The corporation is directly used as an instrument of fraud when it is a mere shell without assets and is the record owner

of property, supposedly owned by an individual. For example, a roofing contractor has every outward reason to believe that an occupant of a certain dwelling is the owner and on an order from such person rebuilds the roof. When payment is demanded, claim is put forward that the property is owned by a family or individual corporation, which did not order the work done. Here is a case where judgment should be directed against both the corporation and the individual.

Separate corporate ownership by a small corporation of delivery wagons has prevented recovery against a rich parent newspaper corporation. Will the courts extend this doctrine so as to sustain the practice of a wealthy trucking contractor, who organizes a separate corporation for each truck, capitalized solely with the ownership of that one truck, sometimes mortgaged to its full value?

There is nothing to prevent people from using corporations for these purposes. The courts strive to give appropriate remedies, but always at the cost of expensive and delayed litigation.

So too, there is nothing to prevent the creation of corporations with pretended or vastly overrated assets whose securities are sold at fictitious values, the proceeds of which are nearly if not entirely taken by the salesmen or by the salesmen and the men "higher up" in command. The law will regard the transaction as "theft," "getting money under false pretenses," some form of "larceny" or "fraud," and "blue sky" laws may make their accomplishment difficult, but the business goes on. Just like other more serious crimes which continue to be committed in spite of "statutes for such cases made and provided and against the peace and dignity of the state." Public prosecutors, though tired of undertaking cases where the prosecuting witnesses so often lie down and fail to give the expected help, will prosecute.

The United States government through its protection of the mails stands out as the champion of the defrauded investor. It spares neither time nor expense "to get its man," and like the Canadian Mounted Police, whose record of efficiency created the slogan, it is respected and feared.

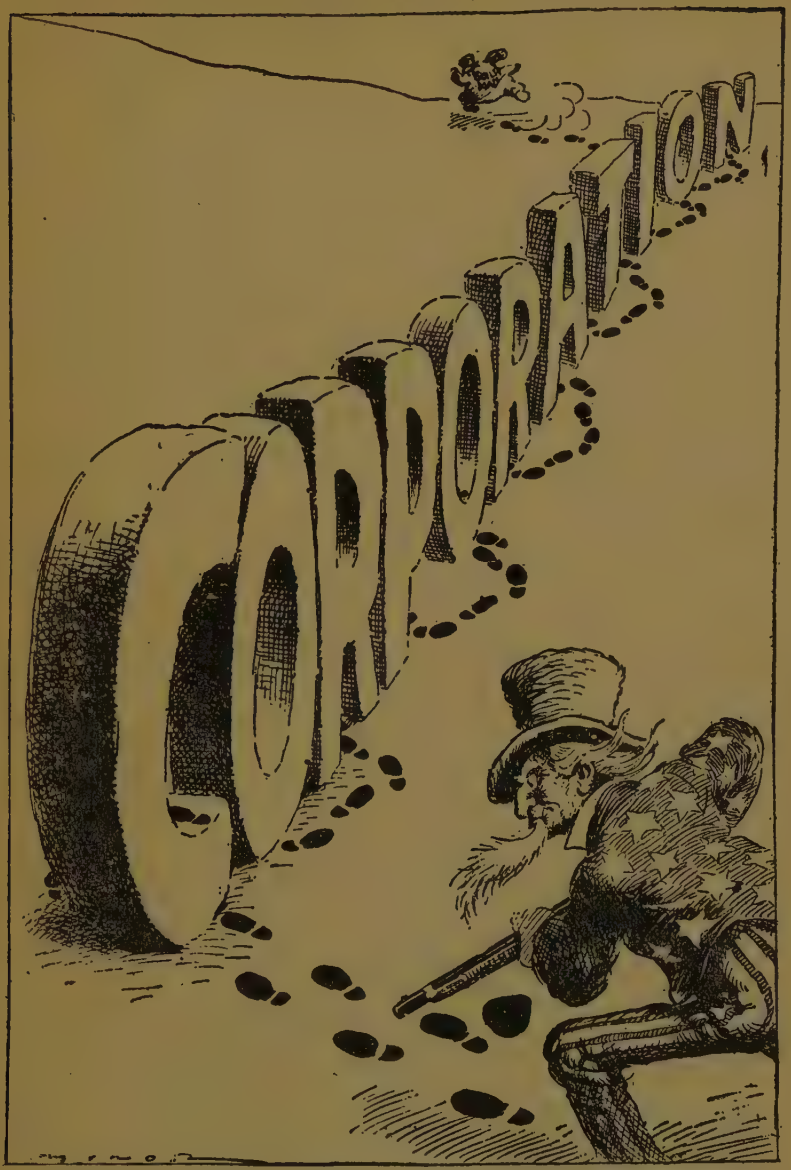
It is the individual who offends—not the corporation itself. Every right-minded and well-intentioned person and especially the government acting for the welfare of all, has a real vital interest in hunting down and driving the "guilty man" from the corporation. It is not always an easy trail to follow.

The corporation itself can be made to look so attractive, substantial, and with such profitable prospects as to deceive the most experienced and astute. The legal wrong may be so hidden as to defy detection. The guilty themselves sometimes think their methods are only "good business." Do you, for example, remember that "Get Rich Quick Wallingford" story where Wallingford organized the Peoples Mutual Bond and Loan Company? He sold stock to the stockholders in a defunct loan company, on the belief that a lottery would be conducted in a manner within the law, then "permitted" himself to be frozen out of the control by a group of local skinflints. Addressing his superior, Blackie Daw (*Young Wallingford,* by George Randolph Chester, p. 157) says:

"I may be a cheese-head, but I don't see why you sold your stock, anyhow. Seems to me you had a good graft there. Why didn't you hold on to it? It was a money maker."

"No," denied Wallingford with decision, "it's an illegal business, Blackie, and I won't have anything to do with an illegal business. The first thing you know that lottery will be in trouble with the federal government and I'm on record as never having conducted any part of it after it became a lottery. Another thing, in less than one year that bunch of crooks will be figuring on how to land the capital prize for themselves under cover. No, Blackie, a quick turn and legal safety for mine. It

"FOLLOW THE TRAIL"—JUDGE LANDIS.



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pays better. Why, I cleaned up thirty thousand dollars net profit on this in three months! Isn't that good pay?"

"It makes a crook look like a fool," admitted Blackie Daw.

Nothing is so easy for the unwholesome and dishonest promoter and stock salesman as imitation of the forms used by the successful. "Styles in stock swindling shift as apparel fashions change," says H. J. Kenner, general manager of the Better Business Bureau, of New York City. "There is scarcely an instrument of or aid to the legitimate securities business that is not at some time appropriated and debased by stock market pariahs to their evil purposes." And *Harper's Magazine,* February, 1928, says:

No matter what kind of methods are employed by the investment banker, the promoter of doubtful or fake securities is going to imitate him, so that there is bound to be a similarity in methods, . . . no matter how the reputable houses act, the disreputable promoters are bound to act as nearly like them as possible. Why not? The crook is certainly not going to give the appearance of being a crook if he can help it. He is not going to advertise the fact of his crookedness; he is going to do everything he can think of to make himself appear to be a respectable vender of profit producing securities.

For example, "blue sky" crooks observe the success of the French Companies in securing capital. "This guy's got something good. Let's go lean on it. It ought to support us for a while. Suckers ought to fall easy for the 50-50 stuff and especially the 100 per cent redeemed preferred argument before payment of common dividends." When such goings-on reach the ears of Mr. French, naturally he gets a little hot under the collar. Says Mr. French:

The officers of the Fred F. French Companies are willing that the French Plan be employed by other real estate companies. They believe it is a move in the right direction in the real estate financing of this country just as they believe that first mortgages and first mortgage bonds are a very necessary type of investment for certain investors and in a certain proportion for all investors. Just as first mortgages and

first mortgage bonds, however, have been set upon by inefficient and unprincipled companies and exploited to the detriment of the conservative mortgage bond companies, they now fear that the French Plan will be similarly exploited.

It is regrettable that organizations composed of practical, earnest, and honorable men may not pursue their business careers without molestation from unwholesome imitators as soon as they receive any small measure of success. The guarding against such dangers is, however, a large part of social and national life and so must be expected in the business life. The French Companies, therefore, intend to jealously guard the French Plan by analyzing the securities of their imitators and by public protest if necessary. They will prevent other companies, if possible, from taking advantage of the attractive form of the French Plan to inveigle investors into purchasing unsafe and unprofitable real estate preferred and common stocks.

We believe that investors' capital is thoroughly safeguarded in such real estate first mortgages as are entered into by the large title companies, insurance companies, and banks in New York City. We cannot but believe, also, in view of the nature of some of the mortgage bonds marketed thus far and in the fear that preferred and common stocks in real estate will also become tainted by misuse, that it is our duty and the duty of all wholesome real estate companies, not only to guard the integrity of their own securities but to assist the public to discriminate.

And so it goes. Only when the shoe pinches does business wake up to the fact that it must do battle against those who misuse its forms. Indeed the successful all owe the public a duty to assist them to "discriminate." *Harper's Magazine,* February, 1928, says:

No one blames the layman investor for not being able to distinguish between the good and the bad. There is no reason why a man not trained in the business of investing money should possess this ability. There is, however, no reason at all why any one should fail to make inquiries about a thing of which he has no knowledge.

Chapter XX

PROTECTION AGAINST UNNECESSARY LOSS

Most of us take a flyer once in a while. We buy stock in some ill-conceived enterprise. If it is an oil company, it drills nothing but dry holes; if it is a mine, the geologist was wrong—there is no "pay dirt"; if it is an invention, it does not work outside of the laboratory or is something that the public does not want. Sometimes the proposition is all right, but the original capital was not enough to see it through, and the novelty of hopes having vanished, courage simply will not come to revive and culminate the effort. The world is dotted with deserted weather-beaten oil derricks, mute monuments of happy anticipation long ago passed on. Every mountain has its clutter of little houses around "mines" once crowded with activity and enthusiasm, now forlorn in their abandonment. Every village has its vacant machine shop or factory, idle now but once thriving with an industry that was to be the "making of the town."

The dream does not come to an end until the money is all gone. Then the first impulse is to accuse every one of being dishonest. In the anguish of loss of money and of hopes, how natural the wail of denunciation! Like the inherent right of the disappointed litigant mentioned by the old English judge, to accompany his lawyer to the nearest inn and there together curse the court. When time has worn the edge off, it is realized that the promoters are not crooks. Generally they have sunk all their own money in the failure. It is just another case of mistaken identity. They thought they were in a "good thing."

Always there is a new crop coming on. Spirit of adventure

—the lure of the other man's game! The old maxims—"Let everyone engage in the business with which he is best acquainted"; "The shoemaker should stick to his last"—are all well enough in their way, but how tiresome! Then there is contrary advice so often repeated—"nothing ventured, nothing gained." Our friend down the street seems to have more and to get it easier than we do. We see only the outside results and glamour of his work, none of the inside disappointments and drudgery. And he sees ours in the same light. He usually detects the risks in his business and we detect those in ours; but we lack the experience, the skill to detect those in the other fellow's line of business. The fact that the new opportunity is not wholly taken up by those in the same business should be warning enough, but it never is. "Investigate before you invest." But who does? Or doing so follows the advice he receives. "Invest and then investigate" is the common practice, as any broker will tell you.

And then, too, in this other fellow's business there is a remoteness and enchantment of distance which familiarity has long ago taken from our own immediate work. The "Spell of the Yukon!" How many an investor's dollar has it lured into amateur mining! The distant hills are the purplest—how happy the far-away "blue sky." Not a cloud in sight. And so our hard cash goes into the intangible and dissolves into the "stuff that dreams are made of." Then along comes the Legislature and says "blue sky" is an improper commodity for you or any one else to trade in. You shall "buy no more of it." "Blue sky" commissions are set up and officers are appointed which will detect and rout out the gold bricks and the lemons, and make me save my money and when I invest, invest wisely and safely, in spite of myself. Thank goodness some one knows how to do these things.

The soundest kind of investment advice is offered in every

direction, but there seems to be a hesitancy to avail oneself of it fully. It is not only for the inexperienced in business that these aids should be taken advantage of; every one having funds to invest should not let opportunity for real aid go unheeded.

The National Bank of Commerce in New York says:

> Dilettantes and experimenters are no more successful in private investment than in other fields. The sound management of funds requires years of training and experience and constant application to the day-to-day problems of finance. The man whose best thought and effort are devoted to other pursuits cannot compete with highly trained investment specialists operating in their own field any more than he can compete with the automobile mechanic or the watchmaker in his vocation. Investment is even more technical; it is a scientific profession. . . . The delegation of investment duties to a recognized investment authority is not an act of weakness. On the contrary, it is the display of sound judgment.

How can the average small investor be expected to use facilities for good investment information, when the average business man is so neglectful? Nobody, perhaps, is better qualified to express an opinion on this subject, than Roger W. Babson, and he says:

> Few people fully realize the losses which are encountered by business men in connection with their investments. . . . Most business men will spend months in making a few thousand dollars which they will "invest" in a few minutes. It is said that the average business man gives less time to the selection of an investment from a bond circular than he gives to the selection of a lunch from a menu card.
>
> Business men should give even more time and study to the investment of money than to the making of it, as money is harder to conserve than to accumulate.

The campaign to educate the general public in investments and particularly to ward off the machinations of the stock swindler includes the use of a questionnaire, which the in-

tended investor is expected to use in the course of the stock-salesmen's solicitations and persuasions.

One of these, referred to as the "Acid Test for Securities" or "Fourteen Questions compiled by Edward A. Schwab, Chief Investigator of the National Vigilance Committee and Better Business Bureaus, which every prospective investor should ask," is as follows:

1. What is the Company's legal name; when and where was it incorporated and what is its capitalization, authorized and issued?
   Answer.
2. Who are the men in actual control and conducting the affairs of the Company, and what is their experience and reputation?
   Answer.
3. Will your bank or any other reliable institution say that the house offering the security is reputable and conservative?
   Answer.
4. Is the nature of the business of the Company such as to insure a continuing demand for its product or service?
   Answer.
5. What provision is made for paying off this and other securities of the Company?
   Answer.
6. What is the character of the physical property of the Company and what is its value in relation to the total securities issued?
   Answer.
7. How much of a margin did the Company earn annually over all its depreciation and interest charges for each of the last ten years?
   Answer.
8. What dividends has the Company paid on its stock for each of the last ten years?
   Answer.
9. What is the relation between the Company's current assets and liabilities and has it sufficient funds to carry on its business?
   Answer.
10. What is the purpose of this issue?
    Answer.
11. What commission is paid to salesmen and others for the sale of this issue?

Answer.

12. What is the net cost of financing to the Company?
    Answer.
13. Will banks accept the securities as collateral on loans?
    Answer.
14. Is the security listed; if so, on what exchange?
    Answer.

Get these facts and then talk to a Banker.
It is his business to help you.

The National Vigilance Committee does not recommend or pass upon any securities.

Another form is a four-page leaflet, which contains the following advice on the first and last pages:

GET YOUR BANKER'S ADVICE FIRST

IT WILL COST YOU NOTHING!
IT MAY SAVE YOU FROM SERIOUS LOSS!

INVESTOR'S
QUESTIONNAIRE

Compiled by the
New Jersey Bankers Association

Whenever you are solicited to purchase Stock or other securities, USE THIS QUESTIONNAIRE before investing any of your funds.

When the stock salesman calls, request him to fill it out. Then take it to any Banking Institution in your community; they will gladly make an investigation for you and pass on the merits of the security offered.

NEW JERSEY BANKERS ASSOCIATION

BEFORE YOU INVEST
I N V E S T I G A T E

In a sentence, that's the message and purpose of this Questionnaire. And remember this one bit of caution may save you from the loss of thousands of dollars. Again, we say investigate.

DO NOT BE CONFUSED BY MISREPRESENTATION

Do not be influenced by colorful arguments. Refuse to be persuaded into risking your money because someone else has.

Common sense will tell you there are no short-cuts to certain financial independence. For your own best interest, follow then your better judgment before parting with your savings or Liberty Bonds for any stock proposition.

GET THE OPINION OF THE EXPERIENCED AND RELIABLE BANKERS IN YOUR COMMUNITY

They have a sincere interest in you and can help you determine the true color and worth of any stock promotion scheme.

NEW JERSEY BANKERS ASSOCIATION

The inside contains the following note and list of questions:

IMPORTANT

This Questionnaire was compiled by the New Jersey Bankers Association to protect the small investor and to emphasize the necessity of investigating thoroughly every investment proposition before placing any money therein. When you have been furnished with the information called for in this Questionnaire, then take it to any one of the Banking Institutions in your community and get their opinion of the stock offered. If the stock-salesman refuses to fill out this questionnaire, have nothing more to do with his proposition, as it is evident that he is fostering a fraudulent promotion.

QUESTIONNAIRE

Date .....
Name of company .....
Name of salesman .....
Kind of stock offered .....
Total issue of stock .....

Stock given for property .....
Stock given for good will .....
Stock given for patents .....
Are you taking any Liberty Bonds?.....
If so, at what price? .....
Amount of cash needed .....
Par value of stock .....
Market price of stock .....
Has the stock a ready market? .....
If so, where is it listed? .....
Is the stock accepted by banks as collateral for loans? .....
If so, what banks have accepted it to your knowledge? .....
What are the present net earnings? .....
Bank references .....
.....

Names of Officers	Former Occupation
.....	.....
.....	.....
.....	.....
.....	.....
.....	.....
.....	.....

There can be no doubt that wide distribution and the use, even if limited, of these questionnaires is helpful. They direct intelligent inquiry to vital spots. They are useful to every investor large or small and therefore do not play down to a low level of intelligence or seem to unduly patronize the supposedly ignorant. The fact, of course, is that we are all in the same boat—we all know too little about our investments, actual or solicited. The "smarter than thou" attitude will certainly scare off those who are most in need of advice.

I recently sent for the printed reports of radio talks intended to educate the public in financial matters. We will call them the "advice of the aged sage," though that is not the correct title. The house that is furnishing them is gen-

erous to do so and I dare say they are doing a good work. Far be it from me to say a directly discouraging word about them. They put in plain language many phases of investments. But in such a primer there does not appear to be an iluminating idea in a carload. I can well imagine hundreds, probably thousands, "tuning into another station," as this stuff comes on to the air.

Why not put the stories in concrete form and bring home to the listener what can happen to him? There is a "John Doe" living around every corner who by patience and industry has accumulated his competence of five or ten thousand dollars to have it wiped out almost over night in either a fraudulent or absolutely doomed enterprise. By what grace or power are you not the selfsame John Doe? Why not tell the stories of how the "white-collared" bandits accomplish these things? Give us the concrete examples of "the strong-arm methods"—the typical allusions to the Bell telephone fortunes, and Ford; the man who gets a list of stockholders in the defunct concerns comes and "congratulates you on being a stockholder and surprises you by telling of how, through seeming failure, insiders are now picking up the stock. He knows where you can get some more *very cheap,* much less than what you paid. Why not take advantage of the opportunity to *average* down the cost of your stock and stand to make a big gain?" Give us the stories of the "persuader" who seeks to switch you from securities you hold to something "much better" which he has to offer?

Let the small investor be shown how a one or two per cent gain in increase from principal put away in properly selected securities, would enable him to buy his wife a new fur coat every year, and a new automobile in three or four years, and he will commence to see why he should be interested in advice from people who will guide him to such investments. Let him know that he can be a "partner" in the best proper-

ties accompanied by the "best" brains, and does not need to take chances with the totally "unknown" in order to be in the game and get some of the thrills of anticipated profits.

I have frequently noticed a marked embarrassment on the part of bankers whose advice is sought as a result of this "investigate before you invest campaign." There is no doubt that they feel that the person approaching them is suspicious of the disinterestedness of the adviser. Banks are getting into the security business themselves more and more every day. There is no telling what may happen in periods of keen competition, especially at distant points where advice given is not apt to be disputed by others. Perhaps our banker friends will develop some "strong-arm" or so-called "high-pressure" methods of their own. But they are not apt to do so. The "strong light that beats upon their throne" alone ought to be enough to prevent. At any rate the public is learning and learning fast. The era of the small stockholder brings the power of greater knowledge and let us hope the greater wisdom.

Those interested in the effort to teach the public to "discriminate," may help by giving wider distribution of advice such as that furnished by James Oliver Murdock, an assistant to the United States District Attorney in New York. Mr. Murdock has had vast experience in prosecutions of "mail frauds." His list of "don'ts" for prospective victims is:

1. Never buy a security where the profits are pointed out to be extremely large. If the representations were true, you would never be offered the opportunity to participate in the venture.

2. Never buy a security where a salesman uses high pressure and insistent methods to get you to buy. If the proposition isn't sound enough on its merits for you to make up your own mind, you had better avoid it.

3. Never buy into a new venture. Established businesses with long earning records are better dividend payers.

4. Never remit any money directly to a strange financial house. It is

much safer to send your money through your bank to a New York bank which can secure delivery of your stock or bonds at the time your funds are delivered.

5. Make an independent investigation of every house you deal with. You can do this through your own banker.

6. Check up representations on every security you wish to purchase through some source other than the seller. Do this through your banker or through standard investment information which is published by such organizations as the Standard Statistics Company and Moody's Manuals.

In August, 1922, request came to the Corporation Trust Company, from a committee of the New York Stock Exchange, for an expression of opinion and any suggestions relating to "Improvement in conditions with reference to the sale of securities and the promotion of corporations." I prepared and delivered the following memorandum:

(1) The laws should be changed so as to recognize the difference between closely held companies and those in which the public is expected to participate. After an experience preceding our own, England has this system, and in view of the fact that their experience is very similar to our own—except that it has developed earlier—is in itself an argument in favor of the system. Under the English law, any company, association, or partnership having for its object the acquisition of gain, which consists of more than twenty persons, or in the case of a banking business, of more than ten persons—must register.

In the case of so-called public companies, the prospectus, if any, must be made available at a nominal cost to all persons interested.

(2) All public companies, making no distinction between individuals, partnerships, or corporations in business, adapting the English system to our own, should be required to file with the Secretary of State a prospectus or statement containing a statement of essential facts of the proposed business. The details required would be different for the various kinds of business, but in all instances a record should be made of the amount of stock issued the officers or directors directly or indirectly and a statement of the consideration paid for the same.

(3) The laws against fraud should be more strictly enforced. I think as a whole these laws are adequate. In the event of legislation suggested in the above paragraph (2) specific penalties for misrepresentation should be provided. In order to secure a more adequate enforcement of the

present laws, I suggest that a Bureau of Publicity or a press agent be employed to give publicity and praise where due in the case of public officials, for enforcing the laws against fraud. I think this is the most important thing that can be accomplished. Prosecuting attorneys are primarily politicians. They become interested in the prosecution of cases which give them the most political credit. If propaganda is systematically carried out through which such credit is secured, they will soon respond and undertake the vigorous prosecution of cases of this character.

(4) I suggest that the Stock Exchange and others interested in this problem maintain a Bureau of Information with regard to investments of all kinds, and that advertisements be inserted in publications in the various localities, as the occasion requires, notifying any one to make use of this Bureau in reference to any form of investment in securities which he may intend to make. This Bureau of Information should keep in touch with conditions throughout the country and when it learns of fraudulent practices being undertaken in any different locality, the press agent of the Bureau should see that the local publications are informed and the light of publicity brought on the activities of the fraudulent brokers or promoters.

To summarize my suggestions: I would compel representations to be made in regard to securities and then have the laws more strictly enforced, aided by an interested and more systematic form of publicity than is at present used.

Some of the things suggested above have gone into effect. The most marked success seems to me to be the "Better Business Bureau," especially in the publicity which they have fostered in the expcsure of stock frauds. A notable political career, namely that of Attorney General Ottinger, of New York, was largely advanced in this manner. The Better Business Bureau made it known that it was at Mr. Ottinger's instance that "teeth" were put into the Martin Act; that he organized a Fraud Bureau on a statewide basis; that he continually drew attention to the enormous size of the annual losses due to stock frauds. It was stated that $500,000,000 annually had been taken from the pockets of the public by stock and bond swindlers in New York State. Later on, the New York *Herald Tribune,* October 21, 1928, stated

that Andrew W. Mellon, Secretary of the United States Treasury, said that such persons milked the general public throughout the nation of as much as $1,000,000,000 a year.

By Ottinger's work in this one respect a saving of at least $350,000,000 a year can be accounted for. This the better business bureaus have estimated by computing the amount of capital stock of non-existing companies remaining undisposed of after injunction, arrest, indictment, or other action by the Attorney General.

Mr. Ottinger has testified to the value of the newspaper and magazine publicity cooperation:

"I am convinced that over fifty per cent of the effectiveness of our Stock Fraud Bureau in combating the security swindlers is due to the wide publicity given to our work in the columns of the press."

It is often difficult to say just where the line of legitimate risk begins. Many ideas now appear safe enough which yesterday were regarded as too hazardous for any man's money. And no doubt it will ever be thus. Leeway must be left open for experiment and for the free play of opinions other than our own.

And even a loss now and then from the operations of those entirely reckless with regard to their methods may be a necessary part of the education of the rising young business men of an enterprising nation. Thus is dedicated "Get Rich Quick Wallingford," the classic portrayal of the fraudulent promoter by George Randolph Chester:

To the live business men of America—those who have been stung and those who have yet to undergo that painful experience—this little tale is sympathetically dedicated.

Consider for a moment some of the risks that confront every enterprise. The list is so long that it helps to classify them. For convenience, they may be divided into legal, economic, financial, and management.

Legal. In this day of super legislation, business finds itself bound down in every direction by legal restrictions. The

legal risk is whether the business contemplated is itself free from prohibition, whether the manner of proposed execution is legal and whether all forms, licenses, and permits have been complied with and received. When J. P. Morgan, Senior, made the remark, "the legal is the greatest risk," we should remember that it was not only a banker who spoke, but the speculative banker of "big business." The statement referred to may be accepted as true in respect to such business, the amounts involved being so large and the legal risk often being such an extremely "uncertain" one.

Economic. To the ordinary business, the economic risk looms up in a large way. Does the business meet a real need? Are the conditions of supply and demand, costs of material and labor, such as to render the making of profits to any degree a certainty? This risk is so important in the mind of the ordinary investor that ordinarily he gives thought to it alone to the exclusion of the other risks.

Financial. Rarely a business is over-financed; that is to say, it has more capital than it can profitably employ. The reverse is the usual trouble and it is a common risk for a business to fail because of insufficient capital. That this may occur is an ordinary and quite usual business risk.

Management. When every other factor has been successfully met, there still remains the outstanding risk of management. Is it capable? Is it experienced? Is it honest? So many questions arise involving the variables of human capacity. The personal element has unlimited capacity to destroy the best business in the world, and good management can lift a doubtful enterprise to brilliant success.

What further can be done to protect the investor against corporate fraud, the sale of fraudulent securities, and his own folly in supporting enterprises clearly foreordained to failure? We have statutes directed against particular acts, like illegal payment of dividends, lending corporate funds

to officers, also particular application of laws against larceny and embezzlement of corporate funds. We have noted activity in the enforcement of federal laws against the use of the mails to defraud,[1] and of criminal conspiracies.[2] Then there are the restraining acts like the Martin Law in New York, "blue sky" laws, in most of the states directed against the sale of fraudulent securities. Then there are the voluntary movements outside of the strictly legal—the Better Business Bureaus and united efforts of savings banks, investment bankers, and brokers generally to furnish information and to assist the investor in the campaign, the slogan of which is "investigate before you invest."

The initiated are thoroughly discouraged with the mere thought of more legislation of any kind. Having in mind particularly rules to be applied in disregarding the "corporate fiction" in order to reach the "man behind," to prevent and rectify fraud, I. M. Wormser[3] says:

> Would legislation be of any avail? Could the law of corporations be "restated" or "codified" so as to formulate a series of propositions which could be automatically applied? In my judgment this is not only impossible but preposterous. . . . What we need are not more statutes. There are already too many of them. Statute making, even ahead of bootlegging, is the chief American occupation. The law should be allowed to develop as a slow, steady growth, sloughing off bad precedents from time to time and making new ones to meet the demands of a developing human society. Too numerous statutes are subversive of the very spirit and theory of our system of law.

But some new statutes are necessary to clear the situation, even if they are limited to acts repealing statutes now in existence. My recommendations are simple and I hope to express them briefly. I suggest that the so-called "blue sky"

[1] Sec. 215 U. S. Criminal Code.

[2] Sec. 37 U. S. Criminal Code.

[3] "The Disregard of the Corporate Fiction and Allied Corporate Problems," pp. 37-39.

laws be eliminated; that states which do not have laws similar to the Martin Act in New York enact a similar law; that there be added to this act provisions requiring that there be furnished to every prospective investor in every new issue of securities a prospectus, or statement in lieu of prospectus,[4] similar to that required in England; that limitations be enacted against sale of such securities by oral representation, house to house canvassing, sale by telephone, etc., as provided in England.[5]

I recommend that the activities of the Better Business Bureaus, and similar movements, be encouraged in every possible way, and especially that the acts of public officials in enforcing the law against fraud be given favorable publicity, so as to induce still greater activity on the part of such officials, usually ambitious for political advancement. I believe that the most fruitful results will be obtained by a continued and an enlarged propaganda of public education in matters of corporation finance and investment.

I favor the program of the Investment Bankers Association for added help to the Post Office Department, in ascertaining violations of law and the enforcement of fraud orders; *i.e.*, increase in number of inspectors detailed to security frauds, also increase in the Solicitor's office of the number of attorneys assigned to this class of work.

[4] See Appendix.

[5] British Company Law, as amended by 17, Geo. 5, Clause 85.

Chapter XXI

TAXATION; THE STOCKHOLDER'S PARAMOUNT INTEREST

"THE power to tax is the power to destroy." Chief Justice Marshall's famous dictum in McCulloch vs. Maryland, has a ring to it that strikes terror to the heart. Unconsciously, and by dint of accumulation of multiple taxation from many sources, the truth of the saying at times comes well-nigh being illustrated by extinction of the corporation form. Of course, it is within the power of taxing authority to accomplish this openly and with avowed purpose, but so far, thank goodness, it has not been done. Incorporation may be driven from one state, city, or community to another in search of a haven of lesser taxation, but the rate of any one tax has but in few instances been so heavy as to prevent incorporation altogether. The accumulation of franchise, income, property taxes directly against the corporation in its home state and in every foreign state, country, or province in which it does business or owns property, together with taxes on the security holder of personal property, income taxes and against his estate of inheritance taxes, perhaps in several jurisdictions—*in the aggregate*—emphasizes importance of the subject of taxation to nearly every corporation and to nearly every owner of corporate securities.

The corporation must continuously strive to keep from being unfairly and unjustly taxed, and it seems to me that it is its duty to seek out and adopt every fair, honest, and aboveboard method to save or minimize its taxes. The corporation that does not do this is put to a serious disadvantage in meeting competition. Its cost of doing business because

of excessive taxation may become so great that it will be compelled to add to its prices or deteriorate its products to a degree which will eventually destroy the business altogether. Taxation frequently compels the adoption of a corporate structure, including borrowed capital to an unnecessary extent, or the creation of more than one company—complications when simplicity could be better—all to save excessive taxes.

Every corporation is interested in the security holder's direct taxation. There is a danger that unwatched taxation from many sources will make corporate investment unattractive. Here the trouble is not only in the amount of tax, but in the nuisance incident to the form of assessing, collecting, or exempting the tax. This nuisance at times and places grows to a point where the investor lays down his hands and says, "What's the use?" "The game is not worth the candle." "My property, though small, is more trouble than it is worth."

The forces of taxation, like gravity, work day and night. There is no national, state, or local patriotism that can resist them. The dollar follows no flag and is loyal to no slogan. Silently it goes back and forth to the place where it pays the least tribute. Taxation becomes the actual means by which every corporate movement or reform is encouraged, retarded, or destroyed. The corporation and the corporate investor are in business to make money, and in spite of whatever may be said, they will eventually make that money with the least possible payment to government. Every other consideration than the making of that money will be submerged. New Jersey eliminated restrictions, brought its laws substantially into line with those of other liberal charter-granting states, and in spite of its convenience to New York City, with its enormous amount of new corporate creations, and in spite of the strongly established reputation of the New Jersey judiciary for just, far-sighted, and constructive cor-

porate decisions, the corporate business does not come back. Why? Because the franchise tax is excessive compared to the standards set by Delaware, Maryland, and other states.

Ohio has recently adopted a new corporate code, deemed by many to constitute a model of clarity, liberality, and constructive helpfulness. Do industrial interests of Ohio organize under it to the exclusion of foreign incorporation? Do residents of other states seek its advantages? They do not. Why? Because Ohio clings to the principle that the situs of taxation follows the domicile of the owner, so that an Ohio corporation pays taxes to Ohio on all its intangibles. Other foreign states may tax some of these in part at least. A corporation doing business in a number of states cannot afford to be exposed to many overlapping or multiple taxes. As a Delaware corporation, for example, its intangibles will theoretically be located in Delaware, and it can actually place tangible evidence of securities, like its stock and bonds, mortgages, patent papers, contracts, with a Delaware trust company or in safe-deposit boxes in that state without attracting any taxes on that account from Delaware. The Delaware tax continues to be confined to a tax based on a corporation's capital stock, and that tax is comparatively nominal.

Likewise does the corporate investor, through a personal or family holding company or by a trusteeship established outside the state of his residence, seek the line of least resistance running parallel with and absorbed by the line of least taxation. This is all very well for the large investor, but we must remember that we are in the age of the small investor. The wealthy investor finds it easy enough to take a residence in Florida, with its alluring winter climate and its exemptions from taxation. He curses about these things and finds great fault, but still there is enough left of income to hire tax experts, alter investments, and to find ways and means to reduce these troubles to a minimum.

The small investor, however, has not enough money at stake to justify these expenditures. The study of the taxes, the filing of returns, are what become expensive in loss of time and bothersome to his nerves. Moreover, he does not relish the leaving of nuisances to his beloved kindred and heirs in the way of securing inheritance tax waivers.

What it all comes to is this:

(1) Taxation will destroy corporate existence itself if not curbed and constantly watched.
(2) The practical corporate reformer will bring principles of taxation to his aid; at least he will not allow them to destroy his efforts.
(3) Every one in any way connected with incorporation and corporate maintenance, in a large sense, is interested in legislative measures which will prevent rate of taxes and methods of assessment, collection, or exemption, from becoming a nuisance—especially to the smaller investor.
(4) It behooves those interested to organize and maintain propaganda which will bring home and keep fixed the thought that there is no real difference between direct personal taxation of the stockholder individually and taxation against him as a group of stockholders—the real owners of a corporation.
(5) That the individual stockholder's identity with his corporation interest with respect to taxation is a reason for cultivating a new attitude of attention toward the stockholder with the expectation of cooperation from him.

Taxation is a field in which the stockholder can help to a greater degree than usually recognized. No doubt the cultivated stockholder will gladly respond when he understands and the corporation on its part appreciates the true situation. There are instances where the corporation gets off with less taxation than the individual, hence the personal holding corporation and the incorporated individual. But these instances are few. For the most part the corporation is taxed right and left nowadays. Of course, it is true of all taxation that the only good tax is the one that only the other fellow has to pay. There is no taxation without damnation.

To complain makes little difference. Sometimes it seems as if the corporation is like the person who complains of a fine levied by a police judge—the amount is only increased.

There is an old maxim that "that tax is best which produces the most feathers with the least squawking." A corporation is at great disadvantage as a tax squawker, but stockholders are not. As all concerned grow to realize that the corporation and the stockholders are one and the same and that all corporate taxation is in reality stockholder taxation, conditions should quickly change. Legislators will no doubt bear in mind that each stockholder has a vote. Some realization of this on the part of corporations is evidenced by two news items which have just come to the writer's attention. One states:

> Some large corporations which pay an income tax of 13½ per cent on profits are attempting to line up stockholders to make a determined effort in Congress for a reduction in this tax. The New Jersey Zinc Company, in mailing its dividend check to stockholders, enclosed the following communication:
>
> "We enclose a dividend check. We are taxed by the Federal Government $13.50 on every $100 income. If we could do business as a partnership you would be paying not to exceed 5 per cent as the individual's normal income tax instead of 13½ per cent as the corporation's income tax. There is a discrimination of 8½ per cent against a corporation to be borne proportionately by its stockholders. You can truthfully say to your Representative in Congress that you, as a stockholder, pay this excessive tax. We believe it would be useful if you should take it up with him and urge a modification of the corporation income tax.

The other news item refers to a somewhat similar statement being mailed to stockholders of textile plants in the Spartanburg, S. C., territory.

Chapter XXII

METHODS OF REDRESS FOR STOCKHOLDERS

THAT we may more clearly understand where we stand, let us make up and briefly consider a list of strict legal rights, powers, and remedies.

1. Every stockholder, however small, has the right to insist that the purposes of the corporation be confined to those stated in its charter. By injunction, if necessary, the courts will see to it that his investment is not diverted into a channel not contemplated. Such acts are called *ultra vires* —beyond the corporate powers. The so-called *ultra vires* doctrine, in which is considered the legal consequences of a corporation exceeding its legal powers, constitutes a veritable maze of legal technicalities, but the right of a stockholder to prevent the continuance of such acts is usually clear.

The classic illustration of the holding of an enterprise strictly to its purposes is the English case of Natusch v. Irving, wherein a fire insurance company was not permitted to go into marine insurance, although the majority, including the wealthy and powerful Rothschilds, favored the change. The complainant, who had paid into the funds of the company only one hundred and fifty pounds as a deposit upon fifteen shares, prevailed in opposition to the wishes of six or seven hundred individuals who had made a total investment of approximately five million pounds sterling. Before the hearing for the restraining order, the defendant had offered to pay back all that the complainant had paid into the company, with interest from date of payment, and also to fully indemnify him against all loss by the transactions of the company already had or thereafter to be had in the business

which was beyond the original articles. Lord Eldon in substance said it is not competent for any number of persons in a partnership (unless so provided) formed for specified purposes to change these purposes without the consent of each partner; to make a partner sell his shares even for double what he paid, and it may be his principal reason for keeping them to have the business carried on according to the original contract.

Holding corporations to a line of conduct strictly within the letter of the law has been the purpose of a considerable amount of corporate litigation. One, Clarence H. Venner, has, by instituting suits for this purpose, made himself widely known and equally obnoxious to many promoters and corporate executives. No doubt many of his cases never reached the courts at all, to say nothing of the higher courts. Records available to us relate to reported cases only, but this is a long list as reference to the note will prove.[1]

[1] Venner v. American Tel., etc., Co., 110 N. Y. Misc. 118 (1920), 180 N. Y. Supp. 45 aff'd, 196 N. Y. App. Div. 400 (1921), 188 N. Y. Supp. 956; Venner v. Atchison, etc., R.R., 28 Fed. 581 (1886); Venner v. Chicago City Ry., 236 Ill. 349 (1908) 86 N. E. 266; Venner v. Chicago City Ry., 152 Ill. App. 398 (1910); Venner v. Chicago, etc., Ry., 258 Ill. 523 (1913), 101 N. E. 949; Venner v. Chicago, etc., Ry., 246 Ill. 170 (1910), 92 N. E. 643; Venner v. Denver, etc., Co., 15 Colo. App. 495 (1900), 63 Pac. 1061; Venner v. Denver, etc., Co., 40 Colo. 212, 90 Pac. 623; Venner v. Great Northern Ry., 209 U. S. 24 (1908), 28 Sup. Ct. 328, 52 L. Ed. 666, aff'g 153 Fed. 408 (1907)—Venner v. Great Northern Ry., 117 Minn. 447 (1912), 136 N. W. 271; Venner v. New York Central, etc., R.R., 81 N. Y. Misc. 298 (1913), 143 N. Y. Supp. 211, aff'd, 160 N. Y. App. Div. 127 (1914), 145 N. Y. Supp. 725, 217 N. Y. 615 (1916), 111 N. E. 487; Venner v. N. Y. Central R.R., 94 N. Y. Misc. 671 (1916), 158 N. Y. Supp. 602, aff'd, 177 N. Y. App. Div. 296 (1917), 164 N. Y. Supp. 626, aff'd, 226 N. Y. 583, 123 N. E. 893; General Inv. Co. v. Lake Shore Ry. Co., 269 Fed. 235 (1920), aff'd 260 U. S. 261 (1922), 43 Supp. Ct. 106; Venner v. Pennsylvania Steel Co., 233 Fed. 407 (1916), 147 C. C. A. 343; Venner v. Pennsylvania Steel Co., 250 Fed. 292 (1918); Venner v. Public Utilities Com., 302 Ill.

It remained for a less litigious complainant, namely Bainbridge Colby, Secretary of State under President Wilson and one-time law partner of the President, to be the moving and defeated party in a suit which brought forth a departure and a new rule so far as the United States is concerned.[2] The New York courts held that a merger of trust companies agreed to by a majority in interest of the stockholders of both companies, may be authorized by statute under the power reserved by the state legislature to amend corporate charters and every stockholder buys stock with implied notice that changes may thus be legally made in his contract. There is no confiscation because provision is made for cash payment to an unwilling stockholder.

This rule goes beyond the doctrine which upholds amendments effectuated by a majority or other interest less than the whole, of the stockholders, pursuant to statute, or charter provision in effect before the non-assenting stockholder buys his stock.

2. To make amendments, to alter the charter, the statutes require the vote of holders of various proportions of stock. Provision for non-voting stock, frequently, does not dispense with the necessity of the vote necessary to effectuate amendments.

3. Power in the stockholders to call meetings, in the event that the regularly constituted officers fail to do so, is usually provided by statute.

4. Power to dissolve. Stockholders, usually by a two-thirds vote at a meeting held upon notice and in the manner

232 (1922), 134 N. E. 17—908; Venner v. Southern Pac. Co., 279 Fed. 832 (1922); Venner v. Michigan R. Com., 205 Mich. 573; General Inv. Co. (a holding company controlled by Clarence H. Venner) v. American Hide & Leather Co., 129 Atl. 244.

[2] Colby v. The Equitable Trust Co. (1908), 124 App. Div. 262, affirmed 192 N. Y. 535, followed in the nearly similar case of Bingham v. Savings Investment Co., 138 Atl. 659.

provided by statute, may dissolve the corporation irrespective of its financial condition. Statutes also usually provide for dissolution without the formality of a meeting, upon unanimous written consent of stockholders. If the corporation is insolvent or unable to give security to those with whom it is dealing, a majority vote may be sufficient to authorize dissolution, all dependent, of course, upon the statutes of the state under which the corporation is organized.

5. To assets on dissolution. After the payment of corporate debts, the stockholder becomes entitled to his proportionate share of the assets of the company. Where preferred stock is outstanding, it becomes necessary to construe provisions of the certificate of incorporation regarding relative rights of preferred and common stock, at which time it will be appreciated if the provisions to be construed are both comprehensive and clear.

6. To sell their stock. The right of alienation is an inseparable incident to the ownership of stock as it is of other property. The word "ownership" implies unrestricted power to dispose of property as one sees fit. Attempts to prevent or restrict the sale of stock in close corporations are often made. The only kind of restriction which can be safely relied upon seems to be in the form of an option in favor of remaining stockholders, in favor of directors, or some named class, by which the stockholder is compelled to make offer of his shares within a limited period at a price to be arrived at by book value, or some form of appraisal, before disposition of such shares elsewhere. This option also runs against the estate of a deceased stockholder and is also frequently made operative in the case of "employee" stock in the event of the employee-stockholder leaving the service of the corporation.

7. To vote. The stockholder is normally entitled to one vote for each share of stock standing in his name on the books of the company. We have discussed voteless stock in

a preceding chapter. The right to attend meetings and vote in person or to be absent and vote by proxy, or to vote by proxy even when present is provided by statute and court decisions.

8. To accumulate his votes in the election of directors, when statute or state constitution make this right compulsory, and to do so where such right is permissive and the certificate of incorporation, etc., provides therefor. See Appendix, p. 244.

9. To dividends.

10. To examine the books.

11. Preemptive right to participate in new issue upon increase of capital stock.

12. To bring legal actions, in a representative capacity for all the stockholders, in the event directors are acting fraudulently in withholding suit, the directors being made defendants along with other parties defendants who have wronged the corporation.

13. To defend suits at law against the corporation is a power vested in the board of directors, but if fraudulently neglected, a stockholder might conceivably act on behalf of and in defense of the corporation.

14. A *bona fide* minority stockholder who has not participated in, or acquiesced in, or ratified fraudulent acts of the majority, or is not the holder of stock from a predecessor thus debarred, may sue and will be given appropriate remedies against an offending majority and in favor of the injured.

A new adjustment to the requirement of greater protection to the stockholder, especially the smaller and the voteless stockholder, is the movement for application by the courts of equitable rights and remedies—a placing of those in control in the position of trustees. This implies the highest standard of conduct known to the law and the strictest reme-

dies applied in legal procedure—the *fiduciary* code, for the protection of the ward in relations with his guardian—of the beneficiary or *cestui que trust* with his trustee—in the broadest terms it is that body of law which exists for the protection of the weak in their relation to the strong.

Great authority implies great responsibility—the spirit of *noblesse oblige*. But courts have thus far enforced a high degree of moral conduct on the part of those in authority in the few instances of the strict fiduciary relations. Many times argument has been made comparing the position of the corporate director in his relations to the stockholder to that of a trustee in his relation to the beneficiary of the trust. Technical distinctions were immediately forthcoming and were for some time sufficient answer to satisfy judges in continuing to deny the relief sought. To the layman, however, results were unsatisfactory. Stockholders appeared, on the whole, to be as helpless as trust beneficiaries and seemed to be entitled to just as efficient legal remedies. Application of the fiduciary rules or code would mean two big things: first, that the director would be obliged to act solely in the interest of the stockholder when his own personal interest came in conflict with that of the stockholder—he could acquire no legitimate profit at the expense of the corporation or of the stockholder. Equity is adamant in its requirement that the trustee shall have no interest in conflict with the beneficiary, unless his action is made known and is fully approved by a beneficiary, having full legal powers and capable of giving binding legal approval, or unless his action is approved by a court having jurisdiction. The other important thing to be accomplished by application of the fiduciary rule is the requirement that the trustee must explain and justify his actions when they appear to conflict with the interests of his beneficiary—a presumption or rule of evidence which assumes that *prima facie* the trustee is guilty. The trust beneficiary

does not possess the details nor is he ordinarily able to secure the necessary evidence. The stockholder today is similarly uninformed and appears to be as badly in need of help as the trust beneficiary ever was.

The existence of a tendency to disregard the technical differences and to secure results without applying the fiduciary rules to directors is clearly shown by the case of Strong v. Repide,[3] and the cases involving somewhat similar facts which have followed. The United States Supreme Court in that case admitted the existence of a general rule that a director in purchasing the shares of a shareholder owes him no duty to disclose the condition of the corporate affairs, *but* announced for the first time a so-called *special facts doctrine,* that where there are special facts an exception exists and a duty is imposed upon the director to make a full and accurate disclosure of all facts known to him and having a bearing on the matter. The special facts in Strong v. Repide which made the director liable to the stockholder for profits realized from the purchase were these: [4]

(1) The director owned a majority of the stock of the corporation; (2) he was the chief negotiator in the sale of the company's lands to the government, which sale was the sole cause of the difference between the real and apparent value of the stock of the corporation at the time of the transaction; (3) the negotiations were for the sale of the entire property of the corporation; (4) through the acquiescence of the shareholders he was acting substantially as their agent in the sale of their stock; (5) he concealed his identity as purchaser from the shareholders. (6) The nature of the corporation itself, as pointed out in a recent case,[5] was also an important circumstance which contributed to the result reached in Strong v. Repide. The land which was owned by the corporation was its only asset, and this was held for the purpose of a favorable opportunity to sell to the government.

[3] (1909) 213 U. S. 419, 53 L. Ed. 853, 29 S. Ct. 521.

[4] Michigan Law Review, May, 1921, page 700.

[5] Haverland v. Lane (1916), 89 Wash. 557, 568, 154 Pac. 1118.

The article referred to analyzes thirteen important decisions rendered by various courts since Strong v. Repide and finds that a majority "have seized upon the special facts doctrine advanced by the Supreme Court of the United States as a means of escape from the rigor of the general rule adhered to by the older decisions." Eight cases [6] imposed a liability in one form or another upon the director for failure to disclose, while there were but five cases in which no liability was imposed. Of these, three declared that they were unable to find any *special* facts.[7] Another of the cases [8] expressed a willingness to follow Strong v. Repide, but held that the rule of that case did not apply inasmuch as the plaintiff was a director and therefore on an equal footing with the defendant. The fifth case [9] held that the relation of director and shareholder was not involved and that consequently the parties dealt on the same basis as any individuals.

The cases were therefore unanimous in evidencing a disposition to apply a remedy which would produce the same results as would flow from a fiduciary relation between director and shareholder, although it was stated that no such relation existed.

A more recent development claims that those in control of a corporation through ownership of a limited class of

[6] George v. Ford (1911), 36 App. Dist. Co. 315; Black v. Simpson (1913), 94 S. C. 312, 77 S. E. 1023; Allen v. Hyatt 17 D. L. R. 7; Jacquith v. Mason (1916), 99 Neb. 509, 156 N. W. 1041; Dawson v. National Life Insurance Co. (1916), 176 Iowa 362, 157 N. W. 929; Poole v. Camden (1916), 79 West Va. 310, 92 S. E. 454; Bollstrom v. Duplex Power Car Co. (1919), 208 Mich. 15, 175 N. W. 429; Gadsden v. Bennetto, 23 Manitoba L. Rep. 33, 9 D. L. R. 719.

[7] Bawden v. Taylor (1912), 254 Ill. 464, 98 N. E. 941; Shaw v. Cole Manufacturing Co. (1915), 132 Tenn. 210, 177 S. W. 479; Haverland v. Lane (1916), 89 Wash. 557, 154 Pac. 1118.

[8] Steinfeld v. Nielson (1914), 15 Ariz. 424, 139 Pac. 879.

[9] Bacon v. Soule (1912), 19 Cal. App. 428, 126 Pac. 384.

voting stock (sometimes called management shares) are *quasi* trustees for voteless stockholders. The valuable views of Adolph A. Berle on the subject, are summarized in the following quotation:

> The banker himself usually has a relatively small cash investment in the corporation; but the management shares are owned or controlled by him. Now the interests of the investment banking house are by no means the same as those of the corporation. It is true that it must please its investors and that success of the corporations it controls tends to do this. It does not follow that in a given corporate situation its first interest will be consideration of the body of non-voting stock; it is possible, if not probable, that there will be attractive opportunities for manipulation of securities, for negotiating favorable contracts with allied interests, or even for giving value to stock which represents no real investment. The investment banking house is invariably in the center of a web of economic interests, to which it renders a real service and from which it derives a real return, but which afford possibilities for profitable transactions not necessarily benefiting the controlled corporations. While the banker's action may be adequately regulated by a high sense of banking ethics which largely prevails among reputable houses, the law can hardly leave investors subject to the doubtful protection of private consciences. Such being the economic fact, it is believed that courts must take cognizance of it in determining how far they will step in to regulate the actions of the controlling group where such control is vested in a minority group. . . .
>
> Equitable controls and relief have heretofore been developed to meet otherwise irremediable situations. Their scope has been enlarged as new fact-situations have arisen. Corporation law has now to deal with such new fact-situations. It is believed that by extending such controls; by placing management stockholders in the class of fiduciaries; by requiring them to insist upon equal contribution from all classes of stockholders; by prohibiting them from utilizing their reserve power wherever they have an individual interest, apart from the corporation in its result; and by fostering upon them liability for mismanagement unless it be shown that they have not concurred in it, modern corporation law will go far toward meeting the problems involved in present business structure.[10]

[10] *Studies in the Law of Corporation Finance*, pp. 44-45, 62-63. Berle, "Non-Voting Stock and Bankers' Control," 39 *Harvard Law Review*,

A New Hampshire decision [11] holds that the relation existing between common stockholders who have entire control of a corporation and preferred stockholders without voting power is that of trustee and *cestui que trust.*

It is interesting to note that the Uniform Business Corporation Act, approved by the American Bar Association in 1928, provides in Section 28, II:

> If by the articles of incorporation, voting power is granted to the holders of shares of a certain class or classes and denied to the holders of shares of other classes, then the person or persons exercising such power shall stand in a fiduciary relation to the entire body of shareholders and shall be responsible to the corporation, for the benefit of all shareholders, for any violation of the obligations of such relationship.

This suggests the possibility of lifting the whole subject of fiduciary relationships in corporate affairs from the difficulties and doubts now surrounding it, by legislative definition and provision.

The writer went into the subject of the ideal of the fiduciary relationship as expressive of the highest degree of practical protection to the investor, in a legal textbook on the subject of Massachusetts Trusts.[12] This form of organization rests purely upon contract, and generally upon common law principles. Statutes generally are confined to provisions for their taxation, filing and recording of declaration

673. A contrary view is expressed by Franklin S. Wood in 38 *Yale Law Journal,* 57-76, November, 1928. He states that the obligations sought to be imposed on management stockholders is greater than that imposed on either a voting trustee or majority stockholder. The objections and suggested limitations of management stockholders are strongly reminiscent of those directed against voting trustees; and when the device of management stock is better known, criticism will probably die down as in the case of voting trusts.

[11] Kidd v. Traction Co. (1907), 74 N. H. 160, 66 Atl. 127.

[12] "Trust Estates as Business Companies," Vernon Law Book Co., Kansas City, Mo.

of trust and agreements and of amendments thereto, also applying the restrictions of so-called "blue sky" laws. Advantages of this form of organization over incorporation depends upon particular circumstances. For holding and investment purposes and for real estate development the Massachusetts Trust often has outstanding favorable features. It is frequently adaptably employed where it is desirable to vest control in a person or group without the necessity of such person or group owning a majority of outstanding capital securities.

Generally described as "common law trusts," trust estates as business companies were at one time extensively used to avoid application of "blue sky" laws, which initially applied to "corporations" only. Amendment of these laws to include "common law trusts" and "associations however formed" has stopped the practice of using trusts in avoidance of security laws. This "blue sky" experience, though brief, was enough to confuse the uninformed, leading to suspicions that this form of doing business was peculiarly advantageous to the illegitimate. The reverse is the fact and truth of the matter. Examination of the cases clearly discloses the direct application of rules of trusteeship, the highest degree of responsibility known to the law, sometimes sought, but not fully attained in fixing corporate liabilities.[13]

I anticipate progress to the point where carefully established trusts, in the so-called "Massachusetts" form, will be more extensively employed for purposes of control and that the investing public will be informed of provisions made for their wider and stronger protection, especially inviting attention to the fact that the management has placed itself on an acknowledged basis of accountability *as fiduciaries.*

Owen D. Young, in January, 1929, in an address at the Park Avenue Baptist Church, New York, avowedly accepted

[13] "Trust Estates as Business Companies," sections 153-158.

the trusteeship idea. He first alluded to the early appointment of lawyers as executives of big business, and then said:

If there is one thing a lawyer is taught it is knowledge of trusteeship and the sacredness of that position. Very soon he saw rising a notion that managers were no longer attorneys for stockholders; they were becoming trustees of an institution.

If you will pardon me for being personal, it makes a great difference in my attitude toward my job as an executive officer of the General Electric Company whether I am a trustee of the institution or an attorney for the investor. If I am a trustee, who are the beneficiaries of the trust? To whom do I owe my obligations?

My conception of it is this: That there are three groups of people who have an interest in that institution. One is the group of fifty-odd thousand people who have put their capital in the company, namely, its stockholders. Another is a group of well toward one hundred thousand people who are putting their labor and their lives into the business of the company. The third group is of customers and the general public.

Customers have a right to demand that a concern so large shall not only do its business honestly and properly, but, further, that it shall meet its public obligations and perform its public duties—in a word, vast as it is, that it should be a good citizen.

Now, I conceive my trust first to be to see to it that the capital which is put into this concern is safe, honestly and wisely used, and paid a fair rate of return. Otherwise we cannot get capital. The worker will have no tools.

Second, that the people who put their labor and lives into this concern get fair wages, continuity of employment, and a recognition of their right to their jobs where they have educated themselves to highly skilled and specialized work.

Third, that the customers get a product which is as represented and that the price is such as is consistent with the obligations to the people who put their capital and labor in.

Last, that the public has a concern functioning in the public interest and performing its duties as a great and good citizen should.

I think what is right in business is influenced very largely by the growing sense of trusteeship which I have described. One no longer feels the obligation to take from labor for the benefit of capital, nor to take from the public for the benefit of both, but rather to administer wisely and fairly in the interest of all.

It is no easy matter to determine right and wrong, even as between the groups which I have indicated. To protect capital one must build up reserves against bad years or unforeseen contingencies. To grant fair wages or high wages and adequately reimburse employees means adjusting the price so as to provide income adequate to do it.

To try to increase price for the sake of labor without regard to whether your labor is efficient, productive, and progressive would be to take the road to ruin. It would destroy continuity of employment because one morning we would wake up and find our business gone; our prices too high; a product not good enough; employees discharged.

Just what is right in all cases we cannot foresee. We make mistakes. We learn from our mistakes. We try to correct them. By and large, looking over the quarter century with which I have been familiar I am pleased with the rapid progress which we are making toward the right in business. We are not perfect and never shall be, but we are training young men with a sense of these great responsibilities, and we are providing them experience from our own mistakes.

As time goes on I feel that the right in business will more and more prevail. The larger business becomes, the more scrupulously careful the administration of it will be. We have had much difficulty with questions of technical competence and moral responsibility in the offices of aldermen, but we have had practically none in the great office of President of the United States. Somehow, as responsibility increases, men are found big enough to meet adequately the great questions of right and wrong which come to them. So I welcome big business and big responsibilities, not in the fear that it will make business wrong, but in the hope and belief that it will make business right.

When thus reviewed the array of stockholders' legal and equitable rights and remedies appear quite formidable. But considered in the light of cold experience, results do not justify enthusiasm.

In the first place, it sounds all well enough, in fact quite thrilling, to speak of adjusting remedies to rights violated and doing justice to all concerned. But how practically can this be done when the party injured is a corporation, a substantial portion of whose stockholders did the wrongs complained of, have parted with their interests and are otherwise judgment-

proof? Or suppose, as usually is the case, that the wrongs complained of stretch over a long period of time, were performed by various parties who have gone in and out of the corporation, successors to whom cannot complain because debarred by consent or laches, and the identity of whom is almost impossible to fix because of the passing of the stock in the meantime from one person to another on the open market. Add to this the complicated state of the facts alleged to constitute the wrongs and the difficulties of proof, where the evidence is almost all in the hands of the opposition, and some light begins to appear on why litigation is not more effectual or more frequently resorted to.

It is often clear that grave corporate injuries have been sustained, but just how the wrongs can possibly be righted is indeed difficult. I shall never forget the impression made on me by John G. Johnson, the famous Philadelphia lawyer, who appeared among the galaxy of talent for the Standard Oil Company at the dissolution suit in St. Louis. Mr. Johnson startled every one with the frankness of his argument, which, as I recall it, began something like this:

> The gentlemen I represent were engaged from the beginning in the laudable pursuit of making money. They have been successful where others have failed. In their zeal they may have committed acts which now examined in the quiet of a court room and removed from the rough frontier days when committed, appear unethical. Business morality has made great strides since that time. For these acts I make no apology whatsoever. As practical men I direct your attention to the fact that the corporation indicted and now before the court is now composed of thousands of stockholders who had nothing to do with these things *whatsoever*. There is no punishment you can inflict upon the corporation which will not bear more heavily upon the innocent than upon the guilty. It is impossible to ascertain and to segregate the guilty and to measure out to them the punishment, if any, which may be due.

In other words the problem of legal rights and remedies in the intricate legal affairs of today is the old problem of

"unscrambling the egg," or putting Humpty-Dumpty back on the wall, or otherwise performing the impossible.

And thus far we have said nothing of the expense and annoyance of litigation to the stockholder who undertakes it. It usually must be "a representative suit," that is to say, for the benefit of the corporation as a whole, and all other stockholders may join who wish to. It is always hoped that they will do so and will share the expense. Sometimes, if the litigation is successful, the whole expense will be fixed by the court against the corporation. But these things remain problematical until the end. In the meantime those "on the inside" use the corporate funds for defense, and relatively speaking seem to have an easy time of it.

Almost any remedy looks better to the experienced stockholder than litigation. Up-to-date information as to what is going on would certainly prevent accumulation of evils to the burdensome extent so often encountered in the past.

Uniting with fellow stockholders and concerted action through committees are the efficient methods today. Laws for a long time have encouraged united action of stockholders, with statutory provisions having fines for penalties, assuring the bona fide stockholder easy access to the list of names and addresses of his fellow stockholders.

Deposit with committees, having broad instructions and powers, is fast developing an effectual plan of united action. A short time ago its use was confined to reorganizations, but it is being used in many other instances of various kinds.

Effectual work of a standing committee of railway security holders suggests a somewhat similar plan for other classes of stock and bond holders.

There remains the remedy of oral and written protest—often the most effectual—and certainly the least costly. Reasonable men give way to strong reasons strongly and reasonably presented. If the right is clear and the wrong is proved,

a taboo will arise far more powerful than the decree of any court. In this day of the small and scattered stockholder the *corporation must be right.* It should take no chances whatsoever to be in the wrong. One unfair corporate act may cause prejudices to arise against the management and against the corporate products and its activities in the minds of the public, which will take years to remove. Certainly any corporation having relations with the public will do well to heed the protest of its smallest stockholder.

The day has come when the public will listen if corporate management does not, and it will too often perhaps render a judgment without mercy, and without benefit of clergy to those who, in their power and might, have sought to crush the small contributor whose only fault is weakness.

How strong an ally will you have once you get the backing of public opinion? Nothing can withstand it for long. Said Judge Gary:

> Public opinion has aroused, and probably always will, the consciences of men and women. Our sleep is broken, our digestion interrupted when we oppose the will of the majority; and we cannot long enjoy life in the face of public disfavor. We dread the condemnation of the general public, especially if there is reason for it. This is true of most persons.

What effect will wide use of investment trusts have upon the enforcement of the rights of the small stockholder? It is possible that they will be quite far reaching in effect in the course of time. Supposedly the holdings of the investment trust will not be small. The aggregate holdings of several investment trusts in a single corporation may be relatively large.

I anticipate that the investment trust, unlike the typical small individual holder, will not be indifferent, apathetic, or supine as to its rights. It will undoubtedly *demand and secure* adequate information with respect to corporate affairs, with a view to increasing or diminishing its holdings. The

investment trust will probably generally be in a position to exercise its rights as a stockholder upon any increase of capital. The investment trust will not fail to take any necessary legal steps to protect its rights as an investor. As before stated, the typical small stockholder will not incur the expense and annoyance of litigation, but the investment trust may well adopt justifiable litigation as a regular part of a fixed policy.

Chapter XXIII

CONCLUSIONS

"If we could know where we are," said Abraham Lincoln, "and whither we are tending, we could better judge what to do and how to do it." Professor Ripley quotes these words at the end of his *Main Street and Wall Street,* apparently as a challenge to further study of some of the corporate problems which we have considered in the foregoing chapters.

Let us take the parts of Lincoln's statement separately and apply them to the various phases of our subject, as developed herein.

First, where are we?

We are in a period of wide distribution of stock. Many thousands of new holders are persons of moderate means.

Stockholders of all classes have become apathetic and indifferent with respect to their legal rights. Whenever they believe themselves mistreated as stockholders or suspect that the affairs of the company are being mismanaged, they usually take their full loss or sell out as best they may. Seldom do they protest, or institute legal proceedings. They do not attend meetings, frequently fail to send back prepared proxies, and make it generally difficult for the management to secure approval of amendments involving new financing, enlargement of purposes, sale of assets, merger, or other deals, sometimes involving the factor of time, with bankers, underwriters, or others.

Promoters of new corporations and directors of established corporations are taking advantage of new laws of liberal charter-granting states, cutting down the stockholders' legal rights, and participation in the company's affairs.

Laws directed against payment of dividends out of principal are effectually defeated by creation of paid-in surpluses under new statutory authority for payment of dividends out of such surpluses in the discretion of directors.

Stockholders are deprived of voting rights by more common use of voting trusts and of the issuance of voteless stock.

The stockholder is fast becoming more and more a mere nonentity with respect to legal rights—is becoming in result identical with the beneficiary of a trust. This emphasizes the fact in the minds of some that directors, majority owners of stock, in other words those in actual control, are in effect trustees and should be obligated as such to protect the stockholder-beneficiary, in accordance with the rules of equity which constitute the highest and strictest code known to our jurisprudence. Others are unwilling to accept this conclusion and seek to negative the obligations of directors and to make them as free in dealing with corporate property and rights as if the property belonged to them personally. The absentee and apathetic attitude of the typical stockholder is encouraging the management to contrive to extend an absolute control.

On the other hand, in order to secure the necessary capital, new enterprises are finding it necessary to offer protection by making the investor a creditor as well as a stockholder, through the sale of notes, or bonds, or a semi-creditor through preferred stock, all with convertible features or common-stock purchase warrants, in order to add a feature of hoped-for speculative profits in addition to the more assured return in the form of interest or preferred dividends.

In other words, the stockholders' fixed rights are waning; their rights to protection against abuse of an indefinite trusteeship is growing.

In spite of lack of protection to individual holders, wide

distribution is sought as desirable to the corporation itself. Stockholders are expected to bring increased business to the corporation as a patron or customer, and to act as a missionary or advertising agent of its goods.

Second, whither we are tending is reduced to a determination of whether, when, and to what extent changes are adopted in the attitude toward the stockholder, and reforms are adopted in present practices. No doubt the present condition will, for the most part, continue for a while longer until appreciation of loss thereby by all the parties in interest becomes more apparent and until financial reverses in corporate affairs generally emphasize the reduced condition of the stockholder's rights.

A more intense competition in securing funds from the public will educate the public in what it should demand and will afford more and more protection to the stockholder, a larger measure of real participation and better treatment in every respect as a competitive means of securing their support.

More extended and more frank disclosures in original offerings; more informative and easily understood reports of financial, industrial, and other conditions by some will force like practice on the part of others.

Third, what to do, and *fourth,* how to do it, is included in suggestions and conclusions, somewhat as follows:

Open and frank statements in offerings, assumption of a high degree of liability, rather than attempts to negative every form of obligation on the part of directors and officers, letters of welcome by executives to new stockholders, analyses of stockholders' lists with respect to occupation, education, etc., frequent correspondence on a human basis supplemental to reports, more easily understood reports of conditions, both financial and otherwise, conduct of stockholders' meetings in a less formal and strictly dry legal manner, using

every possible opportunity to secure inspection of plants and offices, etc., by stockholders, using the stockholder as a means of keeping down taxation, encouraging a general co-operative effort, greater care to select executive officers having the true principles of leadership, capable of attracting loyalty to themselves and to the corporation.

What to do and how to do it:

Various persons interested, *actuated by motives of self-interest,* as well as a desire to accomplish better and bigger things, will put into use some, if not all, of the suggestions discussed in this book, among which are:

Organizers, Promoters:

The projected enterprise should be clothed with convincing simplicity. The new investing public will discriminate as never before and will appreciate realities frankly presented.

Every reasonable safeguard should be adopted to protect the investor, particularly the stockholder.

Alleged convenience of non-voting shares—waiver of pre-emptive rights—waiver of right to question acts of interested directors or any other new method of the "easiest way," however temptingly presented, will probably cause more trouble than they are worth.

More participation by the stockholders, however inconvenient, is greatly to be desired. The hard way will prove the best and really the easiest way in the long run.

There really is utmost skill in common honesty. Simplicity, directness, admission of difficulties, will assist in raising money from an enlightened public far more effectually than all the cleverness and "strong arm" methods that ever were invented.

Owners of control, directors, and officers:

The owner of control should sometimes forego his full legal

power. He should not forever be showing his authority like the tyro policeman or the newly elected justice of the peace.

The small, the minority stockholder, may not have many legal rights, but he may have lots of good sense. If properly paid by consideration and courtesy, he may render returns more lucrative than that of the highest salaried salesman.

There is little use in business for the high hat; it should be left in its box at home. The comedy or tragedy, whichever way you look at it, is that if you are exclusive you have excluded yourself as well as the other fellow. If you have cut others off you are cut off from them. The chances are that you are the greater loser.

The owner of control will be the greatest gainer of all when he adds to his already great strength the real participation and strength of the minority. After all he is but a fraction if even more than half—it still takes the other fraction to make the whole show.

Stockholders:

Painful as disillusionment always is, the time has come when the stockholder must know that there is no Santa Claus. He must know that the dividends he receives are not mere gifts from his corporate stewards. He must realize that these selfsame stewards are first of all selfish individuals actuated in business by motives of personal gain—that when they can profit at the expense of others they may do so.

The stockholder should look things over once in a while. The proprietor should be seen in and about his property. Since the corporate steward always, and the stockholder seldom, is observed to be seen in the corporate vicinity, is there wonder that he and not the stockholder gets to be regarded as the owner?

The stockholder should take as full part as he can and insist that his part be enlarged as much as possible. May it not continue to be said that the ordinary stockholder takes

no more interest in the business than he does "in the daily activities of the coolies of Hongkong."

Corporation lawyers:

The corporation lawyer should turn some of that wonderful talent and ingenuity of his by which he has so skillfully devised convenient corporate ways and means for promoter and banker, to formulating ways and means for the greater protection of stockholders, particularly the minority stockholders. We don't want any more legislation. The corporation lawyer has done fairly well for the bondholder; it will be interesting to see what he can do for the stockholder when he really puts his mind to it.

The corporation has been successful because it has been the means of aggregating the contributions of numerous investors. It will be far more successful when it will attract the aggregate contributions of improving ideas. What we need most of all today are concrete, creative suggestions and action by those who, having the courage of their convictions, will carry on with patience, in spite of indifference, ridicule, or even objection on the part of those to be benefited.

Appendix

A. EMPLOYEE STOCK OWNERSHIP

The Massachusetts Statute providing for representation of employees of a corporation on its Board of Directors reads as follows:

A manufacturing corporation may provide by by-law for the nomination and election by its employees of one or more of them as members of its board of directors. All such elections shall be held at the works of the corporation on the day of the annual meeting, and the voting shall be by secret ballot. If less than a majority of those entitled to vote participate in the election there shall be no election, and the vacancy shall be filled as provided in the preceding section. A director elected by the employees shall have the same rights and powers and shall be subject to the same duties and responsibilities as a director elected by the stockholders. (Section 23, Chapter 156, General Laws, 1921.)

B. CORPORATE STRUCTURE

SPECIFIC CLAUSES IN RECENT CERTIFICATES OF INCORPORATION

Removal of Director.—(4) Any director or directors may be removed at any time, with or without cause, by the affirmative vote given in person or by proxy of the holders of at least two-thirds of the shares of stock of the corporation then outstanding and entitled to vote.—General Outdoor Advertising Co., Inc. (N. J.).

Waiver of Stockholders' Preemptive Rights.—(6) In the event that any new class of stock shall be created, or the authorized number of shares of any class of stock of the Corporation shall be increased, or there shall be issued any bonds, notes, debentures, or other securities other than stock, convertible into stock, the holders of shares of the Common Stock of the Corporation outstanding at the time such new class of stock, or such increase, is offered for subscription, shall have the right to subscribe for the shares of such new class of stock and for any shares of such increased stock so to be issued, or notes, debentures, or other securities

other than stock convertible into stock, in proportion to the number of shares owned respectively by each of the holders of such Common Stock, but no such subscription rights shall accrue or attach at any time, to the Preferred Stock of the Corporation. No such subscription rights shall accrue or attach to the Common Stock as to any of the shares authorized by this Amended Certificate of Incorporation.—THE AMERICAN MEDICINAL SPIRITS COMPANY (MD.)

Restrictions on Loans and Trading.—(c) The Corporation shall never make any loan to, or extend its credit in aid of, any officer, director, manager, or employee.

(d) The Corporation shall not trade on margins nor sell any security short.

(e) The Corporation shall not participate in any stock pools or joint accounts for market manipulation.—OIL SHARES INCORPORATED (MD.)

Convertible Rights.—The foregoing clauses shall be construed as purposes, objects, and powers, and the matters expressed in each clause shall, except as otherwise expressly provided, be in no wise limited by reference to or inference from the terms of any other clause (or any other matter within the same clause), but shall be regarded as independent purposes, objects, and powers and the enumeration of specified purposes, objects, and powers shall not be construed to exclude, limit, or restrict in any manner any power, right, or privilege given to this corporation by law, or to limit or restrict the meaning of the general terms or the general powers of the corporation, nor shall the expression of one thing be deemed to exclude another, although it be of like nature, not expressed.

Nothing herein contained shall be construed as giving the corporation any rights, powers, or privileges not permitted to it by law, but the occurrence within any of the foregoing clauses of any purpose, power, or object prohibited by the laws of the state of Delaware or of any other state, or of any territory, dependency, or foreign country, in which the corporation may carry on business, shall not invalidate any other purpose, power, or object not so prohibited, by reason of its contiguity or apparent association therewith.

(c) In case the corporation at any time or from time to time, shall accord ratably to all holders of shares of its Common Stock the opportunity to subscribe for additional shares of its stock or other securities or when it shall declare the initial dividend, any special dividend, or make any increase in the rate of regular dividend, payable upon the Common Stock, the corporation will give notice of such opportunity to subscribe or of the declaration of any such dividend, as the case may be, to each holder of a share or shares of Preference Stock, Series A Convertible, by mailing written or printed notice thereof to such holder,

at his address appearing upon the books of the corporation, at least twenty (20) days before the date of expiration of such right to subscribe, or in the case of any such dividend at least ten (10) days before the date for taking a record of common stockholders for the purposes of such dividend; provided that nothing in this subparagraph (c) of subdivision K contained shall be deemed to give to the holders of Preference Stock, Series A Convertible, prior to the exercise of the conversion right, any right accorded to holders of shares of Common Stock.

(d) Fractional shares of Common Stock will not be issued upon conversion of Preference Stock, Series A Convertible; but if upon any such conversion a stockholder shall become entitled to receive a fractional share, the corporation shall, in lieu of such fractional shares, issue non-dividend, non-interest bearing, and non-voting scrip certificates representing such fraction or fractions, in such form as may be approved by the Board of Directors. Such scrip certificates may become void and of no effect after a reasonable period from the date of issue, to be determined by the Board of Directors and stated in such scrip certificates. Such scrip certificates, at any time before becoming void, may be consolidated into certificates for full shares of Common Stock; and if the aggregate face amount of such valid scrip certificates surrendered for consolidation into shares of Common Stock is in excess of a number of even full shares, the corporation, upon delivery of stock certificates for the number of even full shares called for by the surrender of scrip certificates, shall issue a new scrip certificate for the fractional excess.—SOUTHWESTERN STORES, INC. (DEL.)

Directors Dealing With Own Company.—In the absence of fraud, no contract or other transaction between the Corporation and any other corporation shall be in any way invalidated or otherwise affected by the fact that any one or more of the directors of the Corporation are pecuniarily or otherwise interested in, or are directors or officers of, such other corporation. Any director of the Corporation, individually, or any firm or association of which any director may be a member, may be a party to, or may be pecuniarily or otherwise interested in, any contract or transaction of the Corporation, provided that the fact that he individually or as a member of such firm or association is so interested shall be disclosed or shall have been made known to the Board of Directors or a majority of the members thereof; and any director of the Corporation who is also a director or officer of such other corporation or who is so interested may be counted in determining the existence of a quorum at any meeting of the Board of Directors or of any committee of the Corporation which shall authorize any such contract or transaction and may vote thereat to authorize any such contrast or transaction, with like force and effect as if he were not such director or officer of such other

corporation or not so interested. Any contract, transaction, or act of the Corporation or of the directors or of any committee which shall be ratified by a majority of a quorum of the shareholders at any annual meeting, or at any special meeting called for such purpose, shall, in so far as permitted by law, be as valid and as binding as though ratified by every shareholder of the Corporation.—The International Printing Ink Corporation (Ohio)

Cumulative Voting for Directors.—At all elections of directors, each stockholder entitled to vote shall be entitled to as many votes as shall equal the number of his shares of stock entitled to vote multiplied by the number of directors to be elected, and he may cast all of such votes for a single director or may distribute them among the number to be voted for, or any two or more of them, as he may see fit.—Barker Bros. Corporation (Md.)

Waiver of Stockholders' Preemptive Rights.—No holder of the Convertible Preferred Stock of the Corporation shall be entitled as such as a matter of right, to subscribe for or purchase any part of any new or additional issue of stock of any class whatsoever or of securities convertible into stock of any class whatsoever, whether now or hereafter authorized or whether issued for cash, property, or services or by way of dividend and all such rights are waived by each holder of the Convertible Preferred Stock, and no holder of the Common Stock of the Corporation shall be entitled as such as a matter of right to subscribe for or purchase any part of any additional issue of Preferred Stock convertible into Common Stock, whether issued for cash, property, services, or otherwise, and all such rights are waived by each holder of the Common Stock.—Collins & Aikman Company (Del.)

Specific Directions and Limitations Regarding Dividends and Surplus.—So long as any of the preferred stock shall remain outstanding, no additional preferred stock shall be issued by the corporation unless

(1) The net earnings of the corporation and the proper proportion of the net earnings of its subsidiary corporations after all deductions, including adequate amortization of leaseholds carried on the balance sheet, adequate depreciation of and other necessary reserves, and sufficient provision for deferred accounts, extraordinary collection expenses, returns and allowances, and also after deducting Federal income and excess profits taxes, for twelve (12) consecutive calendar months within the fourteen (14) calendar months immediately preceding such issuance, shall have been at least three (3) times the annual dividend requirements on the preferred stock then outstanding and the additional preferred stock proposed to be issued; and the computation of the proper proportion of net earnings of any subsidiary corporation owned by the corporation for a part

but not all of said period or to be acquired simultaneously with the issuance of such additional preferred stock, shall be made on the same basis as though such subsidiary corporation had been owned by the corporation throughout the entire period. Where preferred stock is to be issued for cash, the corporation, in the computation of such net earnings, shall credit the same with a sum equal to six (6%) per cent. on the par value of the preferred stock so proposed to be issued by the corporation; nor unless

(2) The net assets of the corporation and the proper proportions of the net assets of its subsidiary corporations shall be equal to at least one and eighty-five hundredths (1.85) times the par value of the preferred stock then outstanding and the additional preferred stock proposed to be issued; and for the purpose hereof there shall be included in such net assets, the net assets to be received by the corporation for the additional preferred stock then proposed to be issued, including, where the corporation is so to receive shares of stock of another corporation which will thereupon become a subsidiary corporation, a proper proportion of the net assets of such other corporation; provided, however, that leaseholds at not exceeding cost thereof less adequate amortization may be included, and good will shall not in any manner be included, in the computation of such net assets; nor unless

(3) The surplus of the corporation available for dividends on the preferred stock shall be in excess of three (3) times the annual dividend requirements on the preferred stock then outstanding and the additional preferred stock then proposed to be issued; nor unless

(4) The computation of such net earnings and net assets and surplus shall be established by a firm or firms of public accountants of recognized standing in the City of New York.—Weber & Heilbroner, Inc. (Del.)

Payments for Shares—Surplus.—The Corporation may issue its authorized stock, whether authorized by the Certificate of Incorporation or by any amendment thereof, for such consideration (which, in the case of stock having a par value, shall not be less than the par value thereof) as may be fixed from time to time by the Board of Directors; and may receive in payment, in whole or in part, for any stock issued by it, cash, labor done, personal property, or real property or leases thereof, and in the absence of actual fraud in the transaction the judgment of the Board of Directors as to the value of the labor, property, or leases so received shall be conclusive. Any and all shares so issued, the full consideration for which as so fixed by the Board of Directors has been paid or delivered, shall be deemed full paid stock and not liable to any further call or assessment thereon. At the time of the issuance of any shares of stock without par value, the Board of Directors may authorize the

acceptance by the Corporation of any additional moneys or other property to be taken and held by it as reserve or surplus, or may at such time authorize the carrying by the Corporation to reserve or surplus of any part of the consideration for which such shares are issued, and in any such case the amount which shall be carried on the books of the Corporation as capital in respect of the shares of stock so issued shall not include the amount of such additional moneys or other property or of the portion of the consideration so carried to reserve or surplus. Any losses at any time incurred by the Corporation, as well as any dividends or other distribution upon stock, may be charged against any reserve or surplus so established; and such reserve or surplus may be reduced from time to time by the Board of Directors for any of the purposes above specified or by transfer therefrom to capital account.—CHICAGO MILL AND LUMBER CORPORATION (DEL.)

Payment for Shares—Surplus.—The Board of Directors of the Corporation is hereby empowered to authorize the issuance from time to time of shares of the stock of the Corporation without par value of any class, whether now or hereafter authorized, and of securities convertible into shares of its stock without par value of any class, whether now or hereafter authorized, and/or to grant options for the issuance thereof at any future time or times, for such considerations as said Board of Directors may deem advisable, subject to such limitations and restrictions, if any, as may be set forth in the By-Laws of the Corporation. Whenever such stock shall have been issued for a consideration of which or of the value of which a part only shall have been contributed as capital, there shall be credited to reserve or surplus so much of the amount or value of such consideration as is in excess of the part so contributed as capital. Against any reserve or surplus so established, there may be charged losses at any time incurred by the Corporation; also dividends or other distributions on stock. Such reserve or surplus may be reduced from time to time by the Board of Directors for the purposes above specified, or by transfer from such reserve or surplus to capital account or otherwise.

The Board of Directors may from time to time establish, re-establish, amend, alter, or repeal and may put into effect and carry out such a plan or plans as may from time to time be approved by said Board of Directors for the distribution among or sale to the officers and employees of the Corporation, or any of them, in addition to their regular salaries or wages, of any moneys or other property of the Corporation, or of any shares of stock of the Corporation of any class, in consideration for or in recognition of the services rendered by such officers and employees.—TAGGART CORPORATION (MD.)

Enlarged Rights to Holders of Preferred Stocks.—The preferred stock which the Company is authorized to issue may not be increased or decreased without the previous consent of the holders of at least two-thirds of the issued and outstanding preferred stock expressed in writing, nor without either the previous consent, expressed in writing, of all the holders of the issued and outstanding common stock, or the affirmative votes of stockholders owning at least two-thirds of the issued and outstanding common stock given at a meeting specially called for the purpose and in the manner provided by law and the By-Laws of the Company.

The Company shall not mortgage or create any lien, by way of mortgage or otherwise, upon any of its real or personal property, or assent to the creation of any mortgage or lien upon the real or personal property now owned or hereafter acquired by any corporation whereof it may acquire the controlling stock, without either the previous written consent of the holders of at least three-fourths of the then issued and outstanding preferred stock of the Company or the affirmative votes of the holders of at least three-fourths of the then issued and outstanding preferred stock given at a meeting of the preferred stockholders specially called for the purpose, but this prohibition shall not be deemed or construed or operate to apply to or prevent the giving of purchase-money mortgages or other purchase-money liens or any pledging of the stocks, securities, or warehouse certificates of the Company as collateral security for the payment of moneys borrowed by the Company in the regular course of business.—General Cigar Co., Inc. (N. Y.)

Preemptive Right of Shareholders Denied.—No holder of stock of this Corporation, nor any class of stockholders, shall at any time have any preferential right of subscription to any shares of any class of stock of the Corporation now or hereafter authorized, issued, or sold, or to any obligations or securities convertible into stock of the Corporation, or any right of subscription to any thereof, now or hereafter authorized, issued, or sold, other than such, if any, as the Board of Directors in its discretion may determine, and at such prices and on such terms as the Board of Directors may fix pursuant to the authority conferred by law and by this Certificate of Incorporation.—City Stores Company (Del.)

Elaborated Preferred Stock Provisions.—Fourth.—The total number of shares that may be issued by the Corporation is Eight hundred and Sixty thousand (860,000) shares, of which One Hundred Thousand (100,000) shares without nominal or par value shall be Convertible Preference Stock (hereinafter called "Preference Stock") and Seven hundred and Sixty thousand (760,000) shares without nominal or par value shall be Common Stock.

The voting powers, designations, preferences, and relative, participat-

ing, optional, or other special rights or qualifications, limitations, or restrictions of each class of stock are as follows:

(1) Out of the annual net profits of the Corporation, or out of its net assets, in excess of its capital (subject to any limitations prescribed by statute), as and when declared by the board of directors, the holders of the Preference Stock shall be entitled to receive cumulative dividends at the rate of Five Dollars ($5.00) per share per annum, and no more, payable quarterly in cash on the 15th days of February, May, August, and November in each year. Such dividends shall be cumulative from November 15th, 1927, and the first quarterly dividend shall be payable on February 15th, 1928, except that in the case of Preference Stock issued subsequent to February 14th, 1928, the dividends on such stock shall be cumulative only from the first day of the quarterly dividend period in which such stock shall have been issued.

(2) On the 15th days of May and November, 1929, and on the 15th days of May and November in each year thereafter, so long as any of the shares of Preference Stock shall be outstanding, there shall be set aside and credited to a fund for the retirement of the Preference Stock (herein designated as the "Retirement Fund") an amount equivalent to five per cent (5%) of the consolidated net earnings (as hereinafter defined) after deducting therefrom provision for dividends and amortization of indebtedness as hereinafter specified of the Corporation and its subsidiary companies, as hereinafter defined, for the immediately preceding six (6) months' fiscal period ending on February 28th or August 31st, as the case may be. Such amount shall be set apart from, and only from, the semi-annual net profits of the Corporation or out of its net assets in excess of its capital (other than net assets in excess of capital designated as initial or capital surplus and also subject to any limitations prescribed by statute) remaining after full cumulative dividends on the shares of Preference Stock then outstanding for all past quarterly dividend periods shall have been paid, and a sum sufficient for the payment of the full cumulative dividends on the shares of Preference Stock then outstanding for the current quarterly dividend period shall have been declared and paid or declared and set aside.

The amounts so reserved for the Retirement Fund shall be applied by the Corporation to the purchase of shares of the Preference Stock in the open market or at public or private sale, if obtainable, at a price not exceeding Sixty-six dollars ($66) per share, together with a sum equivalent to the accrued and unpaid dividends upon the shares so purchased, provided, that in the event of the purchase of any stock at a price which shall include accrued dividends, the amount of the accrued dividends shall be provided by the Corporation out of its annual net profits or net assets, in excess of capital, as aforesaid, other than the amounts set aside and credited to said Retirement Fund account. If on any April

1st or October 1st after April 1st, 1929, there shall remain in the Retirement Fund the sum of Ten Thousand dollars ($10,000) or more not so applied, such Retirement Fund moneys shall be applied to the redemption of the Preference Stock on the next dividend date in the manner hereinafter prescribed in Section (5) of this Article Fourth, provided, however, that such moneys may be applied up to and including the date of the call for redemption to further purchases of Preference Stock if and to the extent that the same can be purchased as aforesaid at not exceeding the redemption price. The amounts so set aside for the Retirement Fund shall not be made the basis of a stock or cash dividend, or otherwise distributed among the holders of the Common Stock, nor shall said amounts be depleted or used in any way which would interfere with the application thereof as herein provided.

To the extent that the Corporation shall have applied during any six (6) months' fiscal period ending as aforesaid on February 28th or August 31st beginning with the six months' fiscal period ending on February 28th, 1929, any part of its annual net profits or net assets, in excess of its capital, as aforesaid, other than net assets in excess of capital designated as initial or capital surplus and other than any sums previously set aside and credited to the Retirement Fund as in this Section (2) provided, to the purchase or redemption of shares of Preference Stock, it shall be entitled to be credited with the amount so applied (but in no event at a rate in excess of Sixty-six dollars ($66) per share for each share of Preference Stock so purchased or redeemed) on the amount required to be set aside by it and credited to the aforesaid Retirement Fund on the next succeeding May 15th or November 15th, as the case may be. The Corporation shall be entitled to be credited in the same manner with an amount equivalent to the number of shares of Preference Stock converted during any such period into Common Stock pursuant to the provisions of Section (6) of this Article Fourth multiplied by Sixty-six dollars ($66). Shares of Preference Stock purchased for the Retirement Fund, or the purchase or redemption or conversion of which shall be made the basis of a credit in respect of any sum to be set aside and credited to the aforesaid Retirement Fund account, shall not be reissued and no shares of Preference Stock shall be issued in lieu thereof or in exchange therefor, and surplus or net profits growing out of such purchase or redemption or resulting reduction of Preference Stock shall, so long as any Preference Stock shall be outstanding, be unavailable for the purchase of Common Stock or as a basis for Common Stock dividends payable otherwise than in common stock or other charges against surplus.

In the discretion of the board of directors of the Corporation, any moneys at any time set aside to the credit of the Retirement Fund may be used to pay current dividends on the Preference Stock if no other

surplus is available for the purpose. All sums withdrawn from the retirement fund for the payment of dividends on the Preference Stock shall be first made good before any dividends shall be declared or paid upon the Common Stock.

For all provisions of this Article Fourth, the term "subsidiary company" or "subsidiary" shall include the plural as well as the singular thereof and is hereby defined to mean any corporation ninety-five per cent (95%) of whose outstanding shares of stock entitled to vote at any meeting of stockholders whether or not temporarily deprived of its voting power shall be owned by the Corporation and/or a subsidiary.

For all provisions of this Section (2) "consolidated net earnings" of the Corporation and its "subsidiary companies" shall be based upon a consolidated earnings statement or income account prepared in accordance with sound accounting practice and shall be arrived at by deducting from the total gross-rentals or other operating revenue received or accrued, all operating or non-operating expenses including (but not limited to) expenses of reasonable and proper repairs and maintenance of its properties, reserves for depreciation of property and equipment, amortization of leaseholds or property improvements, payments and accruals under rentals, insurance premiums, and charges, reserve for uncollectible accounts, management fees and salaries, interest and taxes and reserves for taxes including (but not limited to) Federal Income Taxes and Franchise Taxes and uninsured losses.

"Consolidated net earnings" shall also include gains or losses from sales of fixed capital assets (not including, however, appreciation of capital assets) of the corporation and of its subsidiaries and from real estate trading after deducting therefrom all commissions or other charges and expenses in respect of such properties. For the purpose of computing the amount of the retirement fund there shall be deducted from "consolidated net earnings" as above defined provisions for dividends and amortization of indebtedness for the period to which such "consolidated net earnings" relate, as follows:

(a) Dividends paid or accrued on Preference Stock of the corporation and of any subsidiary except dividends paid or accrued on preferred stock of any subsidiary held by the corporation.

(b) Amortization of mortgage or other funded indebtedness of the corporation and of its subsidiary companies paid or accrued.

(3) As long as any Preference Stock is outstanding, no dividends shall be paid upon the Common Stock except out of annual net profits available therefor actually earned after November 15, 1927, or out of net assets in excess of the capital of the Corporation (other than net assets in excess of capital designated as initial or capital surplus and also subject to any limitations prescribed by statute), and in no event shall any

dividend whatsoever be declared or paid or set apart for payment, or any distribution made, upon the Common Stock while any of the Preference Stock is outstanding, until (1) the full cumulative dividends as aforesaid on the Preference Stock shall have been declared and paid or declared and set apart for all past quarterly dividend periods; (2) the full cumulative dividends as aforesaid on the Preference Stock for the current quarterly dividend period and the three quarterly dividend periods next succeeding the current quarterly dividend period shall have been declared and paid or declared and set apart, and (3) the Corporation shall have set aside and credited to the Retirement Fund all sums then or theretofore required to be set aside.

Subject to compliance by the Corporation with the provisions of Sections (1) and (2) and this Section (3), such dividends (payable either in cash, Common Stock, or otherwise) as may be determined by the board of directors of the Corporation, may be declared and paid from time to time out of the annual net profits of the Corporation or net assets in excess of its capital (subject to any limitations prescribed by statute) upon the shares of Common Stock and in the event of the declaration and payment of any such dividends, the holders of the Common Stock shall be entitled to the exclusion of the holders of the Preference Stock to share ratably therein.

(4) The Preference Stock shall be preferred over the Common Stock as to both earnings and assets, and in the event of any voluntary or involuntary liquidation, dissolution, or winding up of the Corporation or any reduction of its capital or capital stock resulting in the distribution of any assets to its stockholders, the holders of the Preference Stock shall be entitled, before any assets of the Corporation are distributed among or paid to the holders of the Common Stock, to be paid the sum of Sixty-six dollars ($66) per share, together with a sum of money equivalent to all cumulative dividends, accrued or in arrears (whether or not earned and payable out of any capital assets and/or surplus of the Corporation), but the holders of the Preference Stock shall be entitled to no other or further participation in such distribution, and the holders of the Common Stock shall be entitled, to the exclusion of the holders of the Preference Stock, to share ratably, share and share alike, in all assets of the Corporation remaining after the payment to the holders of the Preference Stock of the full preferential amounts aforesaid. If, upon any such liquidation, dissolution, or winding up of the Corporation, or reduction of its capital or capital stock, the assets distributable among the holders of the Preference Stock shall be insufficient to permit of the payment in full to such holders of the preferential amounts aforesaid, then the entire assets of the Corporation to be distributed shall be distributed among the holders of the Preference Stock then outstanding,

ratably in proportion to the full preferential amounts to which they are respectively entitled.

As used in this Article Fourth, the expression "dividends accrued or in arrears" means, in respect of each share of the Preference Stock, an amount equal to Five Dollars ($5.00) per share for each full year and a pro rata amount thereof for any fraction of a year, from the date from which dividends thereon commenced to accrue to the date as of which the computation is to be made, less the aggregate amount (without interest thereon) of all dividends theretofore paid thereon.

(5) The Corporation, at the option of the board of directors, at any time and from time to time, on any dividend date, may redeem the whole or any part of the Preference Stock by paying to the holders thereof Sixty-six dollars ($66) per share, together with the amount of any dividends accrued or in arrears thereon (the aggregate of said amounts being herein called the "redemption price") or in lieu of such payment, by depositing such redemption price in cash on or prior to said redemption date with such Bank or Trust Company in the Borough of Manhattan, City, County, and State of New York, as may be designated by the board of directors of the Corporation in trust for payment on said redemption date to the holders of the Preference Stock so to be redeemed.

Not less than thirty (30), nor more than sixty (60) days previous notice of redemption of any Preference Stock shall be given by the corporation by mail to the holders of record thereof at their addresses as the same appear on the books of the Corporation and in such other manner as may be prescribed by the by-laws of the Corporation or by resolution of its Corporation or by resolution of its board of directors, and on and after the date fixed in such notice as the date of redemption (unless default be made by the Corporation in the payment and/or deposit of the redemption price pursuant to such notice) all dividends on the Preference Stock so called for redemption shall cease to accrue, and on such date or on any date prior thereto on which the funds for such redemption shall be deposited in trust, as aforesaid, with such Bank or Trust Company in the Borough of Manhattan, City, County, and State of New York, as may be designated by the board of directors of the Corporation (notice of redemption having been given as aforesaid) all rights of holders of the Preference Stock so to be redeemed, as stockholders of the Corporation, shall cease and determine, except the right to receive the redemption price, and no more, from the Corporation. Any such redemption of Preference Stock shall be in such amount and at such place and by such method, whether by lot or pro rata, as shall have been fixed by the board of directors, or if not so fixed, then as from time to time shall be provided by the by-laws of the Corporation or be determined by resolution of its board of directors, or by such other method approved by

the board of directors as then may be required to conform to any rule or regulation of the New York and/or other Stock Exchange, upon which the Preference Stock may at the time be listed. Shares of Preference Stock so redeemed shall not be reissued.

(6) Shares of the Preference Stock may be converted into Common Stock at rates and times and subject to terms and conditions as follows:

(a) Any holder of Preference Stock may from time to time at his option convert any or all of such shares held by him into full-paid and non-assessable shares of Common Stock of the Corporation at any time.

1. During the period from November 15th, 1928 (or such earlier date as may be designated as hereinafter provided), to November 15th, 1929, inclusive, at the rate of four (4) shares of Common Stock for each share of Preference Stock surrendered for conversion;

2. During the period from November 16th, 1929, to November 15th, 1931, inclusive, at the rate of three (3) shares of Common Stock for each share of Preference Stock surrendered for conversion;

3. During the period from November 16th, 1931, to November 15th, 1933, inclusive at the rate of two (2) shares of Common Stock for each share of Preference Stock surrendered for conversion, and

4. During the period from November 16th, 1933, to November 15th, 1937, inclusive, at the rate of one (1) share of Common Stock for each share of Preference Stock surrendered for conversion (said rates as above provided and as adjusted as hereinafter provided are hereinafter called the "basic conversion rates")

and the said right of conversion shall be limited to the aforesaid periods, provided, nevertheless, that the Corporation may, at the option of the board of directors, designate any date prior to and in lieu of November 15th, 1928, as the date upon which the first of said periods shall commence by filing written notice of such earlier date with the Transfer Agent of the Preference Stock at least thirty (30) days prior thereto and by publishing a similar notice or advertisement thereof once in each calendar week (in each instance on any day of the week), for at least two successive weeks before the date so designated, in a daily newspaper printed in the English language and of general circulation in the Borough of Manhattan, the City and State of New York (the first publication to be made at least twenty (20) days and not more than forty (40) days prior to the date so designated).

Any such conversion may be effected by holders of Preference Stock by giving five (5) days' written notice of election to convert shares of said stock, the number of shares and the certificate numbers, and presenting said shares to the Corporation's Transfer Agent, accompanied by the deposit and surrender of the certificates of such stock duly endorsed in blank for transfer. In the event that any of the Preference Stock

shall be called for redemption, the right of conversion shall expire at the close of business on the redemption date, but the requirement of five (5) days' notice shall not so operate as to shorten the time within which the right of conversion may be exercised, which right shall be deemed to have been exercised when notice shall have been given and the Preference Stock shall have been surrendered as aforesaid. Unless otherwise required by law or the by-laws of the Corporation, the stock transfer books shall not be closed at any time during the ten business days next preceding any redemption date.

(b) The basic conversion rates, to wit, the rates specified hereinabove in subdivision (a) of this Section (6), are based upon the value of the Common Stock as now constituted which value shall, until adjusted as hereinafter provided, for all purposes of this subdivision (b) of this Section (6), be assumed to be $8.00 (hereinafter called "basic conversion value"), but such basic conversion value and the basic conversion rates founded thereon, shall be subject to adjustment from time to time in the following manner:

(1) If at any time or from time to time after November 15, 1927, and prior to November 16, 1937, shares of Common Stock be issued by the Corporation to a number in excess of Two Hundred Fifty Thousand (250,000) shares, as such two hundred fifty thousand (250,000) shares from time to time be constituted, and

(i) sold by the Corporation for cash at a price per share which is less than the basic conversion value thereof at the time in effect, or

(ii) issued for property or services at the fair value thereof at the time of acquisition thereof at a price per share which is less than the basic conversion value thereof at the time in effect,

the said basic conversion value shall be adjusted as follows:

There shall be added to the aggregate value (based in the basic conversion value at the time in effect) of the number of shares of such stock outstanding immediately prior to said sale or issue, the aggregate amount of money and/or the fair value in money of the property or services actually received by the Corporation from the sale and/or issue of such additional shares, and the resulting sum shall be divided by the number of shares of such stock outstanding immediately prior to such sale or issue, increased by the aggregate number of additional shares so sold and/or issued, and the quotient resulting from such division shall then become the basic conversion value until the same is again adjusted as provided in this subdivision (b) of this Section (6) of this Article Fourth. In determining the aggregate amount of cash actually received by the Corporation from the sale of additional shares of Common Stock as aforesaid, such determination shall be made without deduction of such reasonable commissions as may have been paid for underwriting, if effected.

(2) If at any time prior to November 16th, 1937, the Corporation shall declare and pay, on or in respect of stock into which the Preference Stock is convertible, any dividend in shares of stock of any class or classes now authorized or hereafter created, such stock shall be deemed to have been sold for cash within the meaning of Paragraph (1) of subdivision (b) of this Section (6), but for a consideration of zero dollars, and zero dollars shall be deemed the aggregate amount of cash actually received by the Corporation from the sale of such additional shares.

(3) If the Corporation shall at any time after November 15, 1927, and prior to November 16, 1937, grant any option or rights to subscribe to any stock into which Preference Stock is convertible, at a price less than the basic conversion value in effect at the time of the granting of said option or rights, the conversion value shall be adjusted in the same manner as if all the shares represented by such option or rights had been sold at the price provided for in such option or rights.

(4) In case the Corporation shall in any manner issue or sell any stock of any class or any obligations of the Corporation convertible into or exchangeable for shares of Common Stock of the Corporation and the conversion price or value per share of Common Stock deliverable upon such exchange or conversion (determined by dividing (a) the total amount received by the Corporation in consideration for the issue or sale of such convertible stock or obligations plus the total amount of premiums, if any, payable to the Corporation upon exchange or conversion, by (b) the total number of shares of Common Stock necessary to effect the exchange or conversion of all such convertible stock or obligations) shall be less than the basic conversion value under the provisions of this Section (6), such issue or sale shall be deemed for the purposes of this Section (6) to be an issue or sale of the total number of shares of Common Stock necessary to effect the exchange or conversion of all such convertible stock or obligations, and the amount received by the Corporation in consideration for the issue or sale of such convertible stock or obligations plus the total amount of premiums, if any, payable to the Corporation upon exchange or conversion shall be deemed to be consideration actually received for the issue or sale of such shares of Common Stock. If such convertible stock or obligations are issued for a consideration other than cash, the board of directors of the Company shall determine the fair market value of such consideration and such convertible stock or obligations shall be deemed for the purposes hereof to have been issued for an amount of cash equal to the value so determined by the board of directors.

So long as any of the Preference Stock shall remain outstanding, the Corporation will not prior to November 16, 1937, issue or sell any stock of any class of the Corporation (other than the present authorized issue

of Common Stock and/or any common stock hereafter authorized, having no greater rights with respect to dividends than the present authorized issue) having any right to participate with the shares of Common Stock in the receipt of dividends or other distributions unless the Corporation shall first offer pro rata to the holders of shares of Preference Stock and the holders of shares of Common Stock of the Corporation on the proportionate basis of the number of shares of Preference Stock and/or Common Stock held by them, as the case may be, the right to subscribe for such stock.

(5) If at any time, or from time to time, prior to November 16, 1937, the Corporation shall change, as a whole, any class of stock into which the Preference Stock is then convertible, into the same or a different number of shares, with or without par value, of the same or of any other class or classes (hereinafter in this paragraph called "New Stock") any holder of Preference Stock, upon conversion thereof, shall be entitled to receive, in lieu of the stock which (on conversion immediately prior to such change) he would have become entitled to receive, but for such change, a number of shares of New Stock equivalent to the number that would have been issued for such shares of stock as he would have been entitled to receive on conversion immediately prior to such change. The basic conversion value then in force shall thereupon remain unchanged or shall be proportionately increased or decreased, as the case may be, in the ratio which the number of shares of stock so changed shall bear to the number of shares of New Stock.

(6) The basic conversion value of the Common Stock shall in no case be deemed to be increased over and above $8 save and except as provided in the preceding Paragraph (5) and/or except upon the change of the right of conversion as provided in subdivision (a) of this Section (6) of this Article Fourth.

(7) Upon any adjustment of the basic conversion value, as hereinbefore provided, the basic conversion rate at the time in effect shall be adjusted as follows: The number of shares of Common Stock or other stock into which a share of the Preference Stock shall then be convertible shall be divided by a fraction whose numerator shall be the basic conversion value after said adjustment, and whose denominator shall be the basic conversion value in effect immediately prior to such adjustment, and the quotient resulting from such division shall be the adjusted conversion rate.

(8) Upon any adjustment of the basic conversion rate as aforesaid, the new basic conversion rate shall continue in effect until another adjustment shall have been made or until the next date fixed for the decrease of the basic conversion rate as above provided. Upon any date fixed for decrease of the basic conversion rate pursuant to the provision of sub-

division (a) of this Section (6), any adjusted basic conversion rate then in effect shall be decreased in the same proportion as is provided for the decrease of the basic conversion rate, to wit, on November 16, 1929, by 25 per cent on November 16, 1931, by 33 1-3 per cent and on November 16, 1933, by 50 per cent.

(9) In each case where the Corporation shall issue or sell any shares of Common Stock in excess of 250,000 shares, or declare and pay a stock dividend on or in respect of stock into which the Preference Stock is convertible, or grant any options or rights to subscribe to any additional shares of its Common Stock, or shall issue or sell any stock or securities convertible into stock into which Preference Stock shall be convertible, or shall change shares of stock into which Preference Stock shall be convertible after November 15, 1927, and prior to November 16, 1937, it shall immediately file with the Transfer Agent of its Preference Stock written notice of the number of shares so issued or which the Corporation is thereafter obligated to issue, and shall also, within thirty (30) days thereafter, file with such Transfer Agent a certificate signed by the President or a Vice-President of the Corporation, showing:

(i) The amount of additional or new shares or convertible shares or securities issued and the date of issue;

(ii) The price or prices at which such shares or convertible shares or securities have been sold, and the cash received by the Corporation from the sale of such share or convertible shares or securities determined as heretofore in this Section (6) provided, or

The terms and conditions upon which the rights or options or the change has been effected, and

(iii) The adjusted conversion rate at which the Preference Stock shall thereafter be convertible.

In case such additional shares or convertible shares or securities shall have been issued for property, the Corporation shall at the same time file with such Transfer Agent a certificate by an expert in valuation of the kind of property or services involved, appointed by the board of directors of the Corporation, certifying the net value of such property.

(10) The Corporation shall not issue fractional shares of its Common Stock in satisfaction of the conversion privilege hereinbefore provided, but in lieu of fractional shares it shall issue non-voting, non-dividend paying script certificates for any fraction of a share in form to be approved by the board of directors of the Corporation. In no event shall any allowance or adjustment be made for dividends on either the Preference or Common Stock upon conversion.

(11) All certificates of Preference Stock surrendered for conversion as hereinbefore provided, shall be cancelled and retired and no further Preference Stock shall be issued in lieu thereof.

(12) In the event that the Corporation shall, prior to November 16, 1937, consolidate or merge with, or shall transfer its property as an entirety, to any other corporation, proper provision shall be made that, on the terms and in the manner provided hereinbefore in this Section, the holder of shares of Preference Stock may thereafter, while the right of conversion exists, convert the same into the same kind and amount of stock, securities and/or assets, as may be issuable and/or payable by the terms of such consolidation, merger, or transfer with respect to the number of shares of the class of stock of the Corporation into which such Preference Stock is convertible at the time of such consolidation, merger or transfer.

(13) An amount of the authorized Common Stock sufficient to provide for the conversion of Preference Stock from time to time outstanding as aforesaid shall at all times be reserved for the purpose of effecting the conversion thereof. No issue of Common Stock at a price less than the basic conversion value then in effect and no issue of any option or right to subscribe for any Common Stock and no issue of any stock or securities convertible into Common Stock and no Common Stock dividend and no issue of Preference Stock in excess of 32,000 shares thereof shall at any time be made unless and until (a) the amount of authorized unissued Common Stock after deducting the amount therefrom, if any, proposed so to be issued, or required for issuance upon the exercise of said option or right to subscribe or required the issuance upon conversion of any such securities or stock or such other dividend, shall at least equal the amount thereof required after the issuance of such shares of Common Stock to be reserved for the purpose of conversion of all outstanding Preference Stock at the basic conversion rate determined as above provided, and (b) the Corporation shall have taken effective corporate action to provide for the issue of such reserved Common Stock for the purpose of such conversion.

(7) The Common Stock shall have the exclusive voting power and the Preference Stock shall have no voting power whatsoever except as otherwise provided by law and as otherwise hereinafter provided in this Section (7) and except that in case of default in the payment in full of dividends aggregating five dollars ($5) on the total amount of the Preference Stock outstanding, whether or not consecutive, the holders of the Preference Stock shall become entitled to full voting rights equally with the holders of the Common Stock (which right shall continue until and terminate when all defaults are remedied).

None of the following matters may be authorized if, within thirty (30) days after written notice shall have been mailed to the holders of record of the Preference Stock outstanding on a date fixed by the board of directors at their last known addresses as they appear on the books of

the Corporation, of the intention of the Corporation to effect such transactions, or any one or more of them, the holders of record on such date of more than thirty-three and one-third per cent (33 1-3%) of the then outstanding Preference Stock shall object thereto in writing, to wit:

(a) The sale, lease, exchange, or other disposition of all or substantially all of the property, rights, privileges, and franchises of the Corporation, or the dissolution of the Corporation;

(b) The merger or consolidation of the Corporation into or with any other corporation, provided, however, that nothing herein contained shall prevent without such notice the consolidation or merger of the Corporation with any subsidiary company, or the sale to the Corporation or to another subsidiary company by any subsidiary company of all or a part of its property;

(c) The incurring of indebtedness by the Corporation or by any subsidiary company of the Corporation by way of guarantee or assumption of obligations of any other corporation or association or of any other person or firm, or by way of guarantee of stocks of other corporations and/or dividends thereon, provided, however, that nothing herein contained shall prevent without such notice the discounting of commercial paper issued in the ordinary course of business;

(d) The creation or authorization by the Corporation of any indebtedness maturing more than twelve (12) months from the date thereof, and indebtedness and obligations secured by a mortgage or pledge on all or any part of the assets of the Corporation, provided, however, that nothing herein contained shall prevent without such notice the pledging by the Corporation of its current assets to secure loans made in the ordinary course of business and maturing within twelve (12) months from the date thereof;

(e) The authorization by any subsidiary company of preferred stock;

(f) The direct acquisition by the Corporation of the fee or leasehold ownership of real property;

(g) The authorization by the Corporation of the engaging by any of its present subsidiaries in any other business than that of owning or operating improved real estate in the City of New York and business incidental thereto.

Any of the foregoing transactions, however, may be carried out by the consent in writing or by the affirmative vote, given in person or by proxy at a meeting of the holders of the Preference Stock duly called and held, of sixty-six and two-thirds per cent (66 2-3%) or such larger per cent of the holders of the outstanding Preference Stock as at the time may be required by law.

All such objections filed by the holders of Preference Stock must be filed on or before the thirtieth (30th) day next succeeding the date of

mailing of notices of such proposed action as hereinbefore provided at such office or agency of the Corporation as shall be designated in such notice, or in the absence of such designation at the principal office of the Transfer Agent of the Preference Stock in the City of New York. The holders of the Preference Stock shall be entitled to notice as aforesaid (and no more) of the intention of the Corporation to take action in respect of the aforesaid matters, and except as provided by law shall not be entitled to receive notice of any meeting of the stockholders called to authorize the same.

Without the affirmative vote of the holders of record of at least sixty-six and two-thirds per cent (66 2-3%) of the outstanding shares of Preference Stock given in person or by proxy at a meeting of the stockholders called and held for that purpose, no amendment shall be made to any of the provisions of this Article Fourth which would

(a) alter or change the preferences or conversion privileges given the Preference Stock so as to affect such stock adversely;

(b) increase or decrease the authorized number of shares of the Preference Stock; or

(c) authorize any class of stock having a preference or priority over or on a parity with the Preference Stock.

(8) The shares of stock of the Corporation without par value, whether Preference or Common Stock, may be issued by the Corporation from time to time for such consideration as may be fixed from time to time by the board of directors of the Corporation, and any and all such shares so issued, the full consideration for which has been paid and delivered, shall be deemed fully paid and not liable to any further call or assessment thereon, and the holders of such shares shall not be liable for any further payments thereon.

(9) No holder of stock of any class of the Corporation shall be entitled as of right (except as otherwise provided in Section (6) of this Article Fourth) to subscribe to and/or purchase any additional or increased stock of any class, whether now or hereafter authorized, or obligations convertible into any class or classes of stock or stock of any class convertible into stock of any other class or classes, and/or obligations, stock, or other securities carrying warrants or rights to subscribe to stock of the Corporation of any class or classes (whether now or hereafter authorized), but any and all shares of stock, bonds, debentures, or other securities or obligations, whether or not convertible into stock or carrying warrants entitling the holders thereof to subscribe to stock, may be issued, sold, and disposed of from time to time by the board of directors to such persons, firm, or corporations, and for such consideration (so far as may be permitted by law) as it shall from time to time in its absolute discretion determine.—Benjamin Winter, Incorporated (Del.)

C. INVITING THE INVESTOR

GREAT BRITAIN.

SCHEDULES.

FIRST SCHEDULE.

PART I.

Form of Statement in lieu of Prospectus to be filed by a Company which does not issue a Prospectus or which does not go to Allotment on a Prospectus issued.

[17 GEO. E.]

THE COMPANIES ACTS, 1908 TO 1927.

Statement in lieu of Prospectus filed by

[*Insert the name of the company.*]

Pursuant to section 30 of the Companies Act, 1927.

Presented for filing by

The nominal share capital of the Company.	£
Divided into	Shares of £ each. " " " " " "
Amount (if any) of above capital which consists of redeemable preference shares.	Shares of £ each.
The date on or before which these shares are, or are liable, to be redeemed.	
Names, descriptions and addresses of directors or proposed directors.	
If the share capital of the Company is divided into different classes of shares, the right of voting at meetings of the Company conferred by, and the rights in respect of capital and dividends at-	

tached to, the several classes of shares respectively.	
Number and amount of shares and debentures agreed to be issued as fully or partly paid up otherwise than in cash.	1. shares of £ fully paid. 2. shares upon which £ per share credited as paid.
The consideration for the intended issue of those shares and debentures.	3. debenture £ . 4. Consideration.
Names and addresses of vendors of property purchased or acquired, or proposed to be purchased or acquired by the Company.	
Amount (in cash, shares, or debentures) payable to each separate vendor.	
Amount (if any) paid or payable (in cash or shares or debentures) for any such property, specifying amount (if any) paid or payable for goodwill.	Total purchase price £ Cash - - £ —— Shares - £ Debentures - £ Goodwill - £ ——
Amount (if any) paid or payable as commission for subscribing or agreeing to subscribe or procuring or agreeing to procure subscriptions for any shares or debentures in the Company; or	Amount paid. " payable.
Rate of the commission	Rate per cent.
Estimated amount of preliminary expenses.	£ .
Amount paid or intended to be paid to any promoter.	Name of promoter. Amount £ .
Consideration for the payment	Consideration:—
Dates of, and parties to, every material contract (other than contracts entered into in the ordinary course of the business intended to be carried on by the Company or entered into more than two years before the filing of this statement).	
Time and place at which the contracts or copies thereof may be inspected.	

Names and addresses of the auditors of the Company (if any).	
Full particulars of the nature and extent of the interest of every director in the promotion of or in the property proposed to be acquired by the Company, or, where the interest of such a director consists in being a partner in a firm, the nature and extent of the interest of the firm, with a statement of all sums paid or agreed to be paid to him or to the firm in cash or shares, or otherwise, by any person either to induce him to become, or to qualify him as, a director, or otherwise for services rendered by him or by the firm in connection with the promotion or formation of the Company.	
If it is proposed to acquire any business, the amount, as certified by the persons by whom the accounts of the business have been audited, of the net profits of the business in respect of each of the three financial years immediately preceding the date of this statement provided that in the case of a business which has been carried on for less than three years and the accounts of which have only been made up in respect of two years or one year the above requirement shall have effect as if references to two years or one year, as the case may be, were substituted for references to three years and in any such case the statement shall say how long the business to be acquired has been carried on.	

(Signatures of the persons above-named as directors or proposed directors, or of their agents authorised in writing.)

Date

NOTE.—In this Schedule the expression "vendor" includes a vendor as defined by section 81 (2) and (3) of the Companies (Consolidation) Act, 1908, and the expression "financial year" has the same meaning as in section 28 of the Companies Act, 1927.

D. CORPORATE CONTROL

Cumulative Voting for Directors

Arizona—Compulsory. Constitution, Art. XIV, Sec. 10, and Rev. Stats. 1913, Sec. 2115.

Arkansas—Compulsory. Act No. 250 of 1927 (Gen. Corp. L.), Sec. 27.

California—Compulsory. Constitution, Art. 12, Sec. 12, and Civil Code, Sec. 307, as amended by L. 1927, Ch. 588.

The California statute regarding cumulative voting is unusual in that it is made to apply to foreign corporations doing business in the state and holding an election of directors in the state. The statute reads as follows:

"All elections must be by ballot, and every stockholder shall have the right to vote in person or by proxy the number of shares standing in his name, as provided in section three hundred and twelve of this code, for as many persons as there are directors to be elected, or to cumulate said shares and give one candidate as many votes as the number of directors multiplied by the number of his shares of stock shall equal, or to distribute them on the same principle among as many candidates as he shall think fit.

"The provisions of this section, so far as it relates to cumulative voting, shall apply to all corporations and associations doing business in this state, having a capital stock or shares of stock and electing directors by a meeting of stockholders held in this state, whether such corporations or associations are organized under the laws of this state or not and no election for directors of any corporation or association, doing business in this state, shall be valid if the right of a stockholder to cumulate his shares as herein provided shall be denied. . . .

"In any case the directors receiving the highest number of votes shall be declared elected. . . ." (Sec. 307, Civil Code, as amended by L. 927, Ch. 588.)

Colorado—Permissive. Compiled Laws, 1921, Sec. 2263.

Delaware—Permissive. Sec. 17, Gen. Corp. Law, as amended by L. 1927, Ch. 85.

Florida—Permissive. Sec. 6554, Compiled General Stats. 1927 (same as Sec. 28, Corporation Act of 1925).

Idaho—Compulsory. Compiled Stats. 1919, Sec. 4713, as amended by L. 1927, Ch. 126.

Illinois—Compulsory. Constitution, Oct. 11, Sec. 3, and Revised Stats. 192, Ch. 32, Sec. 50.

Kansas—Compulsory. Rev. Stats. 1923, Ch. 17, Sec. 17-235.

Kentucky. Compulsory. Carroll's Ky. Stats. 1922, Sec. 552.

Louisiana—Permissive. Sec. 32, subdiv. II, Act 250 of 1928 (new Business Corporation Act effective Jan. 1, 1929, applying to existing as well as new corporations). Permissive also in former law—Sec. 11, Act 267 of 1914.

Maryland—Permissive. Sec. 24, Art. 23, Annotated Code of 1924.

Michigan—Compulsory. Public Acts 1921, Act No. 84, Part II, Ch. 1, Sec. 8.

Minnesota—Permissive. General Stats. 1923, Sec. 7462.

Mississippi—Compulsory. Hemingway's Code, 1927, Sec. 4488.

Missouri—Compulsory. Revised Stats. 1919, Sec. 9732.

Montana—Compulsory. Constitution, Art. XV, Sec. 4, and Revised Codes, 1921, Sec. 5937.

Nebraska—Compulsory. Compiled Stats. 1922, Sec. 457.

Nevada—Permissive. L. 1925, Ch. 177, Sec. 30.

New Jersey—Permissive. General Corporation Act, Sec. 38-a.

New Mexico—Permissive. Codification of 1915 of N. M. Stats., Sec. 924.

New York—Permissive. Stock Corporation Law, Sec. 49.

North Carolina—Permissive except that person holding one-fourth of capital stock may assert right to cumulate votes. Consolidated States. 1919, Sec. 1173.

The North Carolina statute authorizing a provision in the charter for cumulative voting, provides further as follows:

"This right of cumulative voting may be exercised in the absence of charter provision when at the time of the election the stock transfer book of such corporation discloses, or it otherwise appears, that more than one-fourth of the capital stock of the corporation is owned or controlled by one person. A stockholder owning or controlling more than twenty-five per cent of the stock has the same right to vote cumulatively as any other stockholder; and no amendment of the charter or by-laws of a corporation can abrogate or abridge any right herein conferred. The right to vote cumulatively cannot be exercised unless some stockholder announces in open meeting, before the voting for directors, trustees, or managers begins, his purpose to exercise such right, and then every other stockholder may likewise vote cumulatively. (Section 1173, Consolidated Statutes, 1919.)

North Dakota—Compulsory. Constitution, Art. VII, Sec. 137, and Compiled Laws 1913, Sec. 4540.

Ohio—Compulsory if any shareholder gives notice at least twenty-four

hours before meeting that he intends to cumulate votes. General Corporation Act, 1927, Sec. 50.

Pennsylvania—Compulsory. Constitution, Art. XVI, Sec. 4, and Act April 25, 1876, P. L. 47, as amended by Act March 29, 1927, P. L. 70.

Rhode Island—Permissive. General Laws, Revision, 1923, Ch. 248, Sec. 23.

South Carolina—Compulsory. Constitution, Art. IX, Sec. 11, and Civil Code 1922, Sec. 4254.

South Dakota—Compulsory. Constitution, Art. XVII, Sec. 5. (No statutory provision.)

Virginia—Permissive. General Laws, 1923, Sec. 3798.

West Virginia—Compulsory. Barnes' Code 1923, Ch. 53, Sec. 44, as amended by L. 1920, 1st Ses., Ch. 3.

Wyoming—Compulsory. Compiled Stats, 1920, Sec. 5057.

E. MORE AND BETTER INFORMATION FOR THE STOCKHOLDER

THE CORN EXCHANGE BANK
Main Office, William and Beaver Streets

October 1, 1928

DUE INDIVIDUALS, FIRMS, CORPORATIONS AND BANKS...	$240,686,834.30

A conservative banker always has this indebtedness in mind, and arranges his assets so as to be able to meet any request for payment.

For this purpose we have:

CASH ..... (Gold, Bank Notes and Specie) and with legal depositories, returnable on demand.	$33,073,407.22
CHECKS ON OTHER BANKS ..... Payable in one day.	11,826,918.41
U. S. GOVERNMENT SECURITIES	67,387,193.94
LOANS TO INDIVIDUALS AND CORPORATIONS ..... Payable when we ask for them, secured by collateral of greater value than the loans.	60,705,666.52
BONDS ..... Of railroads and other corporations, of first quality and easily salable.	19,046,349.48
LOANS ..... Payable in less than three months on the average, largely secured by collateral.	48,077,689.82

Bonds and Mortgages	20,278,297.61
Banking Houses All located in New York City.	9,058,886.38
Other Real Estate	108,500.00
Total to Meet Indebtedness	$269,562,909.38
This leaves a Capital and Surplus of	$28,876,075.08

Which is a guarantee fund upon which we solict new deposits and retain those which have been lodged with us for many years.

* * *

Our listed resources, enumerated in this statement, do not and can not include those assets of friendliness and helpfulness which this bank has in the personnel of its board of directors, its officers and employees. These are assets which pay dividends to our patrons in service and satisfaction.

(*From New York Herald Tribune,* August 30. 1926)

FINANCIAL STATEMENT OF THE PRUDENCE COMPANY, INC.

The Financial Statement of The Prudence Company, Inc., appearing below, is published for the following reasons:

First, to keep present and prospective holders of Prudence First Mortgages, Prudence-Certificates and Prudence-Bonds accurately informed as to the Financial condition of The Prudence Company.

Second, to enable Prudence investors and the public generally to make an intelligent comparison of the financial condition of this and other first mortgage companies.

Third, to suggest to all investors in first mortgage securities the advisability of securing a statement of financial condition from the companies that sell them.

How Good the Bond is Depends on
How Good the Company is Behind it!

We Have:

(1) CASH Funds on hand or to our credit at authorized depositories (including funds set aside for specific purposes to meet definite obligations on our part).	$16,541,619.93
(2) LOANS ON CALL Due on our request and secured by collateral of greater value than the amount of our loans.	500,000.00

(3) PRUDENCE-BONDS AND CERTIFICATES..... 2,578,950.72

(4) MORTGAGES 12,865,560.08
Prime first liens on real estate, consisting chiefly of advances on buildings being constructed, most of which are pledged with Trustees for specific purposes.

(5) BONDS AND OTHER INVESTMENTS 250,268.40
Choice securities which can be quickly disposed of.

(6) ACCRUED INTEREST 971,965.61
Interest earned to date on mortgages, notes and investments which we will receive in cash when due.

(7) OTHER ASSETS 287,901.10
Consisting of various amounts in process of collection and some small accounts due to us from clients largely secured.

TOTAL RESOURCES $33,996,265.84

We Owe:

(8) INTERIM CERTIFICATES AND SUBSCRIPTIONS .....$ 3,288,166.08
Securities fully paid for by our clients for which they are holding our temporary receipt pending delivery of definite bonds including also payments made by our clients under our Subscription Plan.

(9) AS AGENT 1,137,352.37
Various amounts deposited with us by our borrowers, creating a sinking fund for sums that will fall due on their mortgages at some future date and for other purposes.

(10) PRUDENCE SECURITIES AND COUPONS NOT PRESENTED FOR PAYMENT 232,445.41
These securities are now due and cash has been set aside to pay them when our clients bring them to us for payment.

(11) ACCOUNTS PAYABLE 36,473.97

(12) 5½% BOND ISSUE DUE MAY 1, 1961..... 15,000,000.00
This obligation is specifically secured by cash and securities deposited with the Trustee.

(13) RESERVE FOR INTEREST PAYABLE 1,087,262.59
This amount has been earned on Prudence Securities in the hands of clients and will be paid in cash when due.

(14) RESERVE FOR STATE AND FEDERAL TAXES 270,678.32
This amount has been set aside to be paid to the Government when due.

TOTAL $21,052,378.74

(15) THIS LEAVES A GUARANTEE FUND OF.....$12,943,887.10
Securing each Prudence guaranteed mortgage investment in addition to the prime first mortgages on improved income producing real estate which are held by our clients or pledged with corporate Trustees for their exclusive benefit.

The Prudence Company, Inc., finances all of its first mortgage building operations to completion with its own money. After the buildings are completed and income-producing, the Prudence securities are sold to the public, backed by the unqualified Guarantee of The Prudence Company of over $12,500,000. This Guarantee is the strongest in the world.

THE PRUDENCE COMPANY, INC.

Under Supervision of the New York State Banking Department

F. REAL *versus* PERFUNCTORY MEETINGS OF STOCKHOLDERS

331 Madison Ave., New York 162 Remsen St., Brooklyn

Minutes Annual Meeting of Stockholders Erie Railroad, 1927:

The annual meeting of the stockholders of the Erie Railroad yesterday commanded the greatest interest of any of seven annual railroad meetings which were held. Other meetings included the Northern Pacific, which adjourned for lack of a quorum; the New York, Ontario & Western, the Chicago & Northwestern, the Pennsylvania, and the Union Pacific.

Dr. Henry Shively, who represented 350 shares of first preferred stock, asked in what respect his holdings were preferred and was at a loss to account for the fact that the second preferred stock was selling higher than the common. He appeared to think interests of preferred stockholders were being sacrificed to future interests of the common stockholders. "I have seen a generation of stockholders grow old and die, waiting for dividends that never came," Mr. Shively remarked.

President Burnet assured those who intimated that the time was about ripe for consideration of dividends, that although he could not speak for directors and could offer no assurance of dividends this year or next, he would be glad to lay arguments of preferred stockholders before directors, and would be a fair champion of their cause. The discussion regarding dividends was conducted in a friendly manner.

Another holder of preferred stock, Robert F. Hogue, felt that stock-

holders should have detailed information regarding earnings and position of the coal companies of the Erie. President Burnet replied that from 1915 to 1926, inclusive, the Pennsylvania Coal Company had paid to the Erie around $63,000,000 in dividends. About five years ago surveys of the coal properties showed estimates of about 119,000,000 tons of coal unmined. He said about 5,000,000 tons is being mined each year, and further pointed out that as coal properties are blocked off for mining the amount of taxes is increased.

In view of the fact that the Erie has carried in its balance sheet an item of around $8,000,000 listed as advances to subsidiaries, Mr. Burnet was asked whether Erie officers had any interest in those subsidiaries and were benefiting in any financial way from the advances. Mr. Burnet asserted that to his knowledge none of the Erie officials had any interest in the subsidiaries and in no way had received any benefit. The subsidiaries represent small lines and land companies which were paying no dividends.

There was unanimous approval by stockholders of the saving of $5,000,000 a year in operations.

G. EXTENDED NOTE TO PAGE 69

From *Minimizing Taxes,* by John H. Sears, pp. 9-14, revised to date by citations of new cases:

Obtaining a corporate charter from a state other than that of the residence of the founders of the business or foreign to the state where the principal activities of the business are to be carried on, because of some taxable advantage in organization and subsequent franchise taxes, because of convenience, or because of other advantages of the foreign law, has become a general and well-established practice. "Indeed," says the Supreme Court of North Carolina,[9] "the practice, whether good or evil, of corporations taking out charters in one state to do business solely in others is too general, and has been too long recognized, to be now questioned. It is only necessary that such nonresident corporations shall comply with the requirements of the statute of the state, or states, other than that of its origin, as to the conditions precedent to doing business in such states." A Pennsylvania court[10] points out that because a charter "can be obtained easier and with less expense" in Delaware than in Pennsylvania constitutes no legal wrong.

Cases from other states[11] have considered the question, and, with the few exceptions explained in the notes below, have expressly sustained such action as constituting lawful avoidance as contrasted with evasion. The reasoning of the New York Court of Appeals[12] is of particular interest. In upholding the validity of a New Jersey corporation organized by citizens of New York to do business in New York, the court held that whether this constituted evasion or not was a matter

of law for the court, and not a question of fact for the jury. If it were a question of fact for juries, it might be differently decided at different times and places. "This," the court said, "would be intolerable. It must be a corporation as to all persons with whom it has business dealings, or to none. In other words, it must be a question of law, instead of fact. . . . It is difficult to see how the terms 'evasion' and 'fraud' can be properly applied to acts of our citizens whereby they obtain incorporation in another state. . . . If in any particular case it is thought by those interested in the matter that the business can be done in our own state and by our own citizens with greater facility under the form of a foreign corporation than under that of a domestic one, there is no public policy which forbids its transaction under such form. . . . The truth is, foreign corporations are not properly to be regarded with suspicion, nor should unnecessary restraints be imposed upon their doing business in our midst. They carry no black flag, and the policy of all civilized nations is to grant them recognition in their courts. It seems to me that every reason which urges upon us the recognition of foreign corporations, organized with power to do business in our state and composed of citizens of the foreign state, is equally potent when the foreign corporation is composed of our own citizens. It has always been supposed that a state should at least deal as liberally with its own citizens as with those of foreign states. If, therefore, we permit foreign citizens to come within our limits in the form of a foreign corporation, organized with power to do business here and recognized by us, why should we not permit our own citizens to avail themselves of a like privilege? If we impose terms and conditions upon foreign corporations, as such, doing business here, those same terms and conditions still and equally apply to a foreign corporation when composed of our own citizens. Why should they not be placed at least upon an equality with the foreign citizen?"

"From the opinions sustaining such foreign corporations, however, it is to be noted that emphasis is laid upon legal manner of incorporation in the foreign state[13] and the proper maintenance of a statutory office, holding of meetings in the foreign state, filing of reports, etc.[14] These cases show the importance of employing efficient and responsible agencies as the representatives upon organization and for subsequent corporate maintenance."

NOTE:

(9) Troy & North Carolina Gold Min. Co. v. Snow Lumber Co., 173 N. C. 593, 92 S. E. 494, L. R. A. 1917E, 892 (1917).

(10) Philadelphia & Gulf Steamship Co. v. Soeffing, 59 Pa. Super. Ct. 429 (1915).

(11) Arkansas—Boyington v. Van Etten, 62 Ark. 63, 35 S. W. 622 (1896), holding that when a foreign corporation is once regularly formed,

and until it is dissolved according to the laws of the foreign state, its existence as a corporation cannot be called into question by the foreign state.

California—Stabler v. El Dora Oil Co., 27 Cal. App. 516, 150 Pac. 643 (1915), indirectly recognizes validity of a foreign corporation organized by citizens of California to do business in California. Commonwealth Acceptance Corporation versus Jordan 264 Pac. 796 (1926), holding that a foreign corporation having stock of different par value and also without par value may be admitted to the state.

Florida—Taylor v. Branhan, 35 Fla. 297, 17 South, 552, 39 L. R. A. 362, 48 Am. St. Rep. 249 (1895), regards foreign incorporation as invalid, but lays emphasis on the fact that no effort was made to acquire corporate authority in Florida.

Kansas—State v. Topeka Water Co., 61 Kan. 547, 60 Pac. 337 (1900) holds a foreign charter to be valid, where the corporation has the same powers in the state of incorporation as it seeks to exercise in Kansas.

Kentucky—Cumberland Telegraph & Telephone Co. v. Louisville Home Telephone Co., 114 Ky. 892, 72 S. W. 4 (1903) holds that the validity of a corporation organized in Delaware to do business in Kentucky, because "the laws of Delaware are not so rigorous as the laws of Kentucky," cannot be collaterally attacked.

Massachusetts—Montgomery v. Forbes, 148 Mass. 249, 19 N. E. 342 (1889). In this case, it appears that one George E. Forbes, "for the purpose of limiting his personal responsibility and because the tax laws of New Hampshire were more favorable to corporation than the Massachusetts laws, went to Nashua, New Hampshire, to form a corporation for the manufacture of woolen goods; that he employed an attorney at law of Nashua to incorporate the company in a legal and proper manner, under the laws of that state, and subsequently paid him for his services and disbursements in the premises; that he went to Nashua again, and with the attorney and three other persons, selected and secured by the attorney, signed and executed an agreement of association, which was dated May 6, 1885, and was duly recorded in the office of the Secretary of State of New Hampshire on May 12, 1885, and in the office of the clerk of the city of Nashua on May 13, 1885, and recited that the subscribers associated themselves for the purpose of forming a corporation, to be called the Forbes Woolen Mills, the amount of the capital stock to be $20,000, divided into 400 shares of $50 each; and that the object of the corporation was to manufacture and sell woolen and other goods, and the places of business were Nashua, in New Hampshire, and East Brookfield, in Massachusetts." Subsequently a suit was brought to recover for goods sold to the alleged corporation, and the Supreme Judicial Court of Massachusetts sustained judgment against Forbes individually, permitting the seller to treat a note from the corporation

as void. The court said: "The apparent corporation was not a corporation. The statute of New Hampshire requires five associates, and the articles of agreement must be recorded in the town in which the principal business is to be carried on, and the place in which the business is to be carried on must be distinctly stated in the articles; otherwise, there is no corporation. The defendant's pretended associates were associates only in name: he alone was interested in the enterprise. The articles of agreement were recorded in Nashua, and stated that the business was to be carried on there; but it was not in fact carried on there, and was not intended to be. The defendant took all the shares of the capital stock, and paid in to himself as treasurer only 50 per cent of the amount thereof. This is not a case where there has been a defective organization of a corporation which has a legal existence under a valid charter. Here there was no corporation. It was just the same as if the defendant had done nothing at all in the way of establishing a corporation, but had conducted his business under the name of the Forbes Woolen Mills, calling it a corporation. The business was his personal business which he transacted under that name."

Missouri—The statutes provide that "the Secretary of State shall not license any foreign corporation to do business in Missouri when it shall appear that such corporation was organized under the laws of a foreign state by citizens and residents of Missouri for the purpose of avoiding the laws of this state, as it would be a fraud upon the laws of both states and its pretended incorporators would be held as partners, and as such become liable for the debts of the alleged corporation." Section 3039, Rev. St. 1909. In spite of this provision the Supreme Court held, in State ex rel. Brown Contracting & Building Co. v. Cook 181 Mo. 596, 80 S. W. 929 (1904) with relation to a New Jersey corporation organized by citizens of Missouri: "If in any particular case it is thought by those interested in the matter that a business can be done in our own state and by our own citizens with greater facility under the form of a foreign corporation than under that of a domestic one, there is no public policy which forbids its transactions under such form." To the same effect see Boatmen's Bank v. Gillespie et al. 209 Mo. 217, 108 S. W. 74 (1908). Newell et al. versus Wagner Electric Mfg. Co. 43 S. W. (2d) 1072 (1928), sustaining a Delaware corporation formed to avoid inhibition of Missouri corporations to issue preferred stock in absence of unanimous consent of stockholders. Cases in Missouri to the contrary include facts disclosing fraud in the enterprise as a whole. Journal Co. v. Nelson, 133 Mo. App. 482, 113 S. W. 690 (1908): Tribble V. Halbert, 143 Mo. App. 524, 127 S. W. 618 (1910): Davidson v. Hobson, 59 Mo. App. 130 (1894): Cleaton v. Emery, 49 Mo. App. 345 (1892).

New Jersey—Hill v. Beach, 12 N. J. Eq. 31 (1858) a lower court decision against foreign incorporation. This case is distinguished or

regarded as against the weight of authority in later cases in other states, cited in this note.

New York—Demarest v. Flack. 128 N. Y. 205, 28 N. E. 645, 13 L. R. A. 854 (1891) affirming (Com. Pl.) 11 N. Y. Supp. 83 (1890) quoted in the text above: also Lancaster v. Amsterdam Improv. Co. 140 N. Y. 576, 35 N. E. 964, 24 L. R. A. 322 (1894): U. S. Vinegar Co. v. Schlegel, 143 N. Y. 537, 38 N. E. 729 (1894)—all clearly sustaining foreign incorporation in the sense discussed in this note.

North Carolina—Troy & North Carolina Gold Min. Co. v. Snow Lumber Co., 173 N. C. 593, 92 S. E. 494, L. R. A. 1917E, 892 (1917) clearly sustains foreign incorporation in the sense discussed in this note.

Ohio—Second Nat. Bank of Cincinnati v. Hall, 35 Ohio St. 158 (1878), recognizes foreign incorporation in the sense discussed in this note.

Oklahoma—Lynch v. Perryman, 29, Okl. 615, 119 Pac. 229, Ann. Cas. 1913A, 1065 (1911), holds that parties who attempt to incorporate, but fail because the corporation could not be organized for its declared purpose, or because all its business was to be conducted in a foreign state, are generally held as partners.

Pennsylvania—Philadelphia & Gulf Steamship Co. v. Soeffing, 59 Pa. Super. Ct. 429 (1915), clearly sustains foreign incorporation in the sense discussed in this note.

Rhode Island—Oakdale Mfg. Co. v. Garst, 18 R. I. 484, 28 Atl. 973, 23 L. R. A. 639, 49 Am. St. Rep. 784 (1894), clearly sustains foreign incorporation in the sense discussed in this note.

Texas—Movie Nerve Food Co. v. Baumbach (U. S. C. C. E. D. Texas) 32 Fed. 205 (1887), holds that it is no defense to an action brought by a corporation organized in Maine, when it is shown that its office is located and its elections are carried on in Maine, to allege that the incorporators were all residents of another state, and that it did no manufacturing in the state of incorporation.

Washington—A foreign corporation being a stock structure different from that permitted by the state of Washington may be admitted to do business. It cannot be denied admission merely because its common stock was classified. State ex Fire Land Brick Products, Inc., v. Hinkle, 264 Pac. 1010 (1928).

(12) Demarest v. Flack, 128 N. Y. 205, 28 N. E. 645, 13 L. R. A. 854 (1891), affirming (Com. Pl.) 11 N. Y. Supp. 83 (1890).

(13) Demarest v. Flack, 128 N. Y. 205, 28 N. E. 645, 13 L. R. A. 854 (1891); Boyington v. Van Etten, 62, Ark, 63, 35, S. W. 622 (1896).

(14) Moxie Nerve Food Co. v. Baumbach (C. C.) 32 Fed. 205 (1887).

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